UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, AND JOE E. MCLEMORE,

versus *Appellants,*

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court
for the Northern District of Texas

ON SECOND PETITION FOR REHEARING

[Filed July 15, 1993]

Before POLITZ, Chief Judge and HIGGINBOTHAM, Circuit Judge, and PRADO, District Judge: [1]

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[1] District Judge of the Western District of Texas, sitting by designation.

Per Curiam:

On the second petition for rehearing filed by the Appellee, Archie Bennett, Jr., we hereby AMEND our prior opinion issued April 19, 1993, as follows:

> Judgment is rendered in favor of the limited partners in the amount of 28.4375% of $1,904,204.40.

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Appellants,

v.

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court
for the Northern District of Texas

April 19, 1993

Rehearing and Rehearing En Banc
Denied May 21, 1993

D. Mitchell McFarland, Cynthia L. Osborn, Paul L. Alpern, Liddell, Sapp, Zivley, Hill & LaBoon, Houston, TX, for appellants.

Lenard M. Parkins, Patrick L. Hughes, Sheinfeld, Maley & Kay, Houston, TX, for appellee.

ON PETITION FOR REHEARING

Before POLITZ, Chief Judge and HIGGINBOTHAM, Circuit Judges, and PRADO [1], District Judge.

PRADO, District Judge:

On the petition for rehearing filed by LSP Investment Partnership, we hereby withdraw our prior opinion, published as *LSP Inv. Partnership v. Bennett* (Matter of Bennett), 970 F.2d 138 (5th Cir.1992), and substitute the following opinion in its place.

This appeal arises out of an adversary proceeding in a bankruptcy case [2], in which the bankruptcy court entered an order granting a discharge to the Appellee, Archie Bennett, Jr., over the objection of the Appellants that certain of Mr. Bennett's debts were not dischargeable. In support of their argument, the Appellants rely solely on 11 U.S.C. § 523(a)(4), which provides that debts resulting from a defalcation by the debtor while acting in a fiduciary capacity are not dischargeable in bankruptcy. This Court must decide whether Bennett, as the managing partner of the managing partner of the limited partnership, owed a sufficient fiduciary duty to the limited partners to satisfy the strict requirements of 11 U.S.C. § 523(a)(4). This is a case of first impression in this Circuit.

Standard of Review

Although this case has already been reviewed on appeal by the district court, this Court reviews the bank-

[1] District Judge of the Western District of Texas, sitting by designation.

[2] The underlying bankruptcy proceeding, filed on November 23, 1988, by Archie Bennett, Jr., bears Case No. 388-37142 RCM-7. The adversary proceeding is No. 389-3110.

ruptcy court's findings as if this were an appeal from a trial in the district court. *Killebrew v. Brewer,* 888 F.2d 1516, 1519 (5th Cir.1989). Thus, the bankruptcy court's findings of fact are reviewed under the clearly erroneous standard, and its conclusions of law are reviewed *de novo. Id.*

Background

1. *Bankruptcy Court's Findings of Fact.*

The facts in this case are essentially undisputed.[3] In approximately March of 1980, Bennett and the Appellants formed a Texas limited partnership known as Mariner/Greenspoint, Ltd. ("MG"). The Appellants in this case are and were at all relevant times, limited partners of MG. The sole general partner of MG was another limited partnership, known as Mariner Interest No. 20, Ltd. ("No. 20"). The sole general partner of No. 20 was the Appellee, Archie Bennett, Jr.

Under the terms of the MG partnership agreement, the general partner, No. 20, was charged with management of the partnership and had full, exclusive and complete authority and discretion to manage, control and make all decisions affecting the purposes of the partnership and to take any action required to effectuate the purpose of the partnership. Bennett, as the sole general partner of No. 20, was the only individual with the power or authority to direct the affairs of No. 20 and MG, and was prohibited by the MG partnership agreement from voluntarily withdrawing as the general partner of No. 20.

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[3] The Appellee expressly states that he relies on the bankruptcy court's findings of fact. Appellee's Brief, p. 3. With one partial exception, the Appellants agree that the bankruptcy court's findings of fact are correct. Appellants' Brief, p. 7. The exception, discussed below, is the Appellants' argument that the bankruptcy court erred in failing to find that the $1 million distribution by M/G to Bennett was a defalcation under 11 U.S.C. § 523(a)(4). *Id.* This is a mixed question of law and fact.

The purpose of the MG partnership was to construct and operate a Marriott hotel near the Greenspoint Mall in Houston, Texas. The partnership obtained $22 million, in capital contributions and loans, to cover the cost of constructing the hotel. The MG partnership agreement required the general partner to contribute cash, as necessary, for the costs of constructing, equipping and furnishing the hotel, to the extent such costs exceeded the $22 million previously raised. As an incentive, the agreement also provided that the general partner was eligible to receive a cash distribution of up to $4 million if the project was completed for less than the projected $22 million. However, prior to taking any distribution for savings in the construction of the hotel, the general partner was required both to construct the hotel and to provide all equipment necessary so that it could operate as a "first-class hotel".

At some point early on in the business venture, Bennett retained a corporation, known as Mariner Corporation, to perform his duties as the general partner of No. 20 and, in turn, its duties as general partner of MG. Mariner Corporation was 100% owned by Bennett. The officers and employees of Mariner Corporation acted on Bennett's behalf in performing their duties and were aware that, if the project was completed under budget, the savings would be paid directly to Bennett.

Mariner Corporation obtained bids for the construction of the hotel from a number of general contractors. All of the bids initially submitted were at least $1 million over the budgeted amount of $22 million. After these bids were received, Mariner Corporation entered into negotiations with one of the contractors, Eaves Construction. Subsequently, Eaves dropped its bid price by $1 million and was awarded the contract. Eaves was not able to obtain a bond on the project, however, due to its lack of financial strength and lack of a sufficient track record on large projects. Bennett told Eaves that it could

have the job without a bond, if it reduced its general contractor's fee by one-half. Eaves agreed and reduced its fee by an additional $250,000.

The hotel was completed on time, and opened in January of 1981. At that time Bennett made a $1 million distribution to himself, for completing the project for less than the budgeted $22 million.

Subsequently, several problems with the hotel came to light. First, in approximately April of 1981, mildew began to occur in the guest rooms of the hotel. This mildew was evidently caused by a "negative pressure" problem, which in turn was caused by the design of the heating, ventilation, and air conditioning (HVAC) system in the hotel.[4] As a result of the mildew problem, virtually all of the guest rooms had to be revinyled and resheetrocked twice, during 1981 and 1982.[5]

The bankruptcy court found that the mildew problem at the hotel was a continuous construction problem that the general partner had an obligation to fix and pay for under the terms of the MG partnership agreement. The court found that the first round of repairs was performed at the expense of the general contractor. The second round, however, was charged, by the general partner, to the partnership earnings. The limited partners' share of this cost was $72,000.

The bankruptcy court also reviewed numerous equipment leases that were entered into by the general partner

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[4] "Negative pressure" in a building occurs when more air is exhaused from the building than is made up with conditioned air. The result is that warm, humid air will be drawn into the building to equalize the pressure.

[5] The record indicates that, prior to completion of the hotel, in November of 1980, Bennett was made aware that another Marriott hotel, the Brookhollow Marriott, which had substantially the same HVAC system design as the Greenspoint Marriott, had begun to experience similar mildew problems.

for the purpose of providing various types of equipment to the hotel. The court found that, under the partnership agreement, the general partner had an obligation to equip and furnish the hotel with the $22 million budgeted amount. The court found, with respect to some but not all of these leases, that the general partner had charged them to the partnership, instead of paying for them out of the construction budget. The court also found that Bennett had failed to properly disclose these leases to the limited partners, or to obtain their approval for them. The court determined that the amount wrongfully charged to the limited partners for these equipment leases was $832,204.40.

2. *Bankruptcy Court's Conclusions of Law.*

The bankruptcy court concluded that the misapplication of partnership funds to pay for the mildew repairs and the equipment leases described above were the result of defalcations by the general partner of MB in the total amount of $904,204.40. The court also found that No. 20, as the sole general partner of MG, was a fiduciary to the limited partners of MG, for purposes of section 523(a)(4). The bankruptcy court noted that while Texas courts have not extended the partnership relationship generally to encompass the type of fiduciary duty envisioned by section 523(a)(4), an exception exists for the managing partner of a partnership, who owes to his co-partners, "one of the highest fiduciary duties recognized in law." (Citing *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex.1976); *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ. App.—Austin 1980, writ ref'd n.r.e.)).

The bankruptcy court also found, however, that Bennett, as the general partner of the general partner, did not owe a fiduciary duty to the limited partners of MG. The bankruptcy court stated:

> No. 20 was the fiduciary of MG and only it had an express, technical, preexisting trust relationship with MG, even though Bennett was the managing partner of No. 20.

The bankruptcy court found that Bennett's individual liability to the limited partners of MG came into effect only by reason of the breach by No. 20, and pursuant to the Uniform Partnership Act (UPA) which provides, "[a]ll partners are liable jointly and severally for all debts, and obligations of the partnership. . . ." Tex.Rev. Civ.Stat. Ann. art. 6132b, § 15 (Vernon 1979). The court reasoned that while the UPA made Bennett liable for No. 20's partnership "obligations", it did not create a fiduciary relationship between Bennett and the limited partners of MG. Accordingly, the bankruptcy court granted a discharge to Bennett of all debts, including those which it found to have resulted from defalcations by No. 20, while acting in a fiduciary capacity.

3. *District Court's Order.*

The district court in a brief opinion, affirmed the order of the bankruptcy court granting a discharge to Bennett, but for a different reason. The district court stated:

> Though Bennett was the managing partner of the limited partnership, and Texas courts have imposed a higher degree of fiduciary duty on managing partners, they have done so in the context of constructive, rather than technical, trusts. (Citing *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex.1976); *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ. App.—Austin 1980, writ ref'd n.r.e.)).

Thus, the district court concluded that the high level of fiduciary duty imposed on managing partners of a partnership under Texas law, only arose in the context of a constructive trust and, since constructive trusts are insufficient as a matter of law to meet the express trust

requirements of section 523(a)(4), the district court affirmed the order of the bankruptcy court granting a discharge to Bennett.

Analysis

1. *Fiduciary Duty Under Section 523(a)(4).*

The Bankruptcy Code provides in pertinent part as follows:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (4) for fraud or defalcation while acting in a fiduciary capacity. . . .

11 U.S.C. § 523(a)(4).

The first issue that we address is whether the scope of the fiduciary duty owed by the managing general partner of a limited partnership to the limited partners is sufficient to meet the narrow requirements of section 523(a)(4). Next, we must decide if such a duty also applies to the managing partner of the managing partner.

A number of courts have addressed the issue of whether a partner generally owes the type of fiduciary duty contemplated by section 523(a)(4) to his co-partners. The courts are split on this issue with approximately half finding that such a fiduciary duty is owed,[6]

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[6] *See, e.g., Lewis v. Short* (In re Short), 818 F.2d 693, 695-96 (9th Cir. 1987) (Washington law); *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986) (California law); *Longo v. McLaren* (In re McLaren), 136 B.R. 705, 714 (Bankr.N.D.Ohio 1992); *Gravel v. Chris J. Roy, A Law Corp.* (In re Chris J. Roy), 130 B.R. 214 (Bankr.W.D.La. 1991); *Beebe v. Schwenn* (In re Schwenn, 126 B.R. 351 (D.Colo. 1991); *Getaz v. Stewart* (In re Stewart), 123 B.R. 817 (Bankr.W.D.Tenn. 1991); *Brown v. McKay* (In re McKay), 110 B.R. 764 (Bankr.W.D.Pa. 1990); *Susi v. Mailath* (In re Mailath), 108 B.R. 290, 293-94 (Bankr.N.D.Okla. 1989); *In re Guy*, 101 B.R. 961, 986-91 (Bankr.N.D.Ind. 1988) *In re Cramer*, 93 B.R. 764, 767-68 (M.D.Fla. 1988) *Lee v. Crosswhite* (In re

and the other half finding that it is not.[7]

The seminal case in this Circuit interpreting the discharge provision at issue is *Angelle v. Reed* (In re Angelle), 610 F.2d 1335 (5th Cir.1980).[8] In *Angelle* we reviewed a line of Supreme Court cases discussing and interpreting similar discharge provisions contained in

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Crosswhite), 91 B.R. 156 (Bankr.M.D.Fla. 1988); *Stone v. Stone* (In re Stone), 90 B.R. 71, 79-80 (Bankr.S.D.N.Y.), *aff'd*, 94 B.R. 298, 302-03 (S.D.N.Y. 1988), *aff'd*, 880 F.2d 1318 (2nd Cir. 1989); *In re Dino*, 82 B.R. 184, 186 (Bankr.D.R.I. 1988); *In re Owens*, 54 B.R. 162, 164-65 (Bankr. D.S.C. 1984); *In re Kraus*, 37 B.R. 126, 129 (Bankr.E.D.Mich. 1984). *See also In re Weiner*, 95 B.R. 204, 206-07 (Bankr.D.Kansas 1989) (although no fiduciary relationship between partners generally, the sole managing partner had responsibilities commonly associated with trustee and was therefore a fiduciary under section 523(a)(4)); *In re Hurbace*, 61 B.R. 563, 565-66 (Bankr.W.D.Tex. 1986) (holding that there was insufficient fiduciary relationship between equal copartners to meet requirements of section 523(a)(4), but indicating, in dicta, that managing partner's fiduciary duties probably sufficient).

[7] *Rolley v. Spector* (In re Spector), 133 B.R. 733 (Bankr.E.D. Penn. 1991); *Blashke v. Standard* (In re Standard), 123 B.R. 444 (Bankr.N.D.Ga. 1991); *Sulphur Partnership v. Piscioneri* (In re Piscioneri), 108 B.R. 595 (Bankr.N.D.Ohio 1989); *Stahl v. Lang* (In re Lang), 108 B.R. 586 (Bankr.N.D.Ohio 1989); *Coleman v. Choisnard* (In re Choisnard), 98 B.R. 37 (Bankr.N.D.Okl. 1989); *Medved v. Novak*, (In re Novak), 97 B.R. 47 (Bankr.D.Kan. 1987); *In re Lewis*, 94 B.R. 406, 410 (Bankr.E.D.Va. 1988); *In re Stone*, 91 B.R. 589, 594 (D.Utah 1988); *Dreyfoos v. Ryan* (In re Ryan), 90 B.R. 554 (Bankr.S.D.Fla. 1988); *In re Braudis*, 86 B.R. 1001, 1004 (Bankr.W.D.Mo. 1988); *In re Clemens*, 83 B.R. 945, 951 (Bankr.N.D.Ohio 1988); *In re Napoli*, 82 B.R. 378, 382-83 (Bankr. E.D.Pa. 1988); *In re Elliott*, 66 B.R. 466, 467 (Bankr.S.D.Fla. 1986); *In re Holman*, 42 B.R. 848, 850-51 (Bankr.E.D.Mo. 1984).

[8] In the *Angelle* case we construed section 17a(4) of the former Bankruptcy Act, 11 U.S.C. § 35(a)(4). We have previously noted that while the language of section 523(a)(4) does not precisely parallel that of the predecessor statute, 11 U.S.C. § 35(a)(4), the two statutes are similar enough that decisions construing the prior statute are applicable to section 523(a)(4). *Boyle v. Abilene Lumber, Inc.*, 819 F.2d 583, 587 (5th Cir. 1987).

prior versions of the bankruptcy laws. We held that the concept of fiduciary under 11 U.S.C. § 523(a)(4) is narrowly defined, applying only to technical or express trusts, and not those which the law implies from the contract. *Id.*, (quoting *Chapman v. Forsyth*, 2 U.S. (How.) 202, 207, 11 L.Ed. 236, 238 (1844)). In addition, the requisite trust relationship must exist prior to the act creating the debt and without reference to that act. *Id.*, (citing *Upshur v. Briscoe*, 138 U.S. 365, 378, 11 S.Ct. 313, 317, 34 L.Ed. 931, 936 (1890)). In other words, the trust giving rise to the fiduciary relationship must be imposed prior to any wrongdoing. The debtor must have been a trustee before the wrong and without any reference to it. *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir.1986). Thus, a constructive trust is not sufficient to create a fiduciary relationship for purposes of the discharge provisions of the Bankruptcy Act. *Angelle*, 610 F.2d at 1339; *Ragsdale*, 780 F.2d at 796.

In determining whether a particular debtor was acting in a fiduciary capacity for purposes of section 523(a)(4), the Court must look to both state and federal law. The ~~scope of the~~ concept of fiduciary under 11 U.S.C. § 523(a)(4) is a question of federal law; however, state law is important in determining whether or not a trust obligation exists. *Angelle*, 610 F.2d at 1339.

There has been some disagreement among the courts as to what exactly is meant by the requirement that there be a "technical trust" to satisfy section 523(a)(4). Most courts today, however, recognize that the "technical" or "express" trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law. *See e.g. Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir.1990) (officer of a corporation owed common law fiduciary duty to corporation and stockholders sufficient to satisfy requirements of section 523(a)(4)); *Lewis v. Short* (In re

Short), 818 F.2d 693, 695-96 (9th Cir.1987) (Washington common law imposed trustee-like duties on partners of partnership); *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir.1986) (California common law imposed trustee-like duties on all partners of a partnership); *Carey Lumber Company v. Bell*, 615 F.2d 370, 374 (5th Cir. 1980) (Oklahoma Lien Trust statutes created an express trust). Thus, the trust obligations necessary under section 523(a)(4) can arise pursuant to a statute, common law or a formal trust agreement.

2. *Fiduciary Duties of Managing Partners Under Texas Law.*

The controlling law in this case is Texas law. Therefore, this Court must look to Texas law in order to determine what obligations are imposed on the managing general partner of a limited partnership with respect to the limited partners. The Court must then decide whether the obligations imposed under state law are sufficient to meet the federal law requirements of "fiduciary capacity" under section 523(a)(4).

In addressing this issue, both the bankruptcy court and the district court below referred to and relied on the case of *In re Hurbace*, 61 B.R. 563 (Bankr.W.D.Tex. 1986). In that case, involving a general partnership, the court addressed the issue of whether the debtor should be denied a discharge under section 523(a)(4) for a judgment entered against him in state court for his failure to account to one of his former partners for certain partnership funds. *Id.* at 564-65. The *Hurbace* court looked to the Texas version of the Uniform Partnership Act (UPA), in order to determine whether the requisite trust relationship existed for purposes of section 523(a)(4). The court focused on the following language:

> Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other part-

> ners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

Tex.Rev.Civ.Stat.Ann. art. 6132b, § 21 (Vernon 1979). The court stated that the phrase "hold as trustee" did not establish a technical or express trust for purposes of section 523(a)(4). More to the point, the court found that, "[u]nder the Texas statute, the trust arises only when the partner derives profits without the consent of the other partners. Therefore, the statute would fall within the ambit of a trust *ex maleficio* specifically excluded from the purview of nondischargeable debts under § 523 (a)(4)." *In re Hurbace*, 61 B.R. at 566. The *Hurbace* court's interpretation of the UPA is in accord with those decisions cited above in which this UPA provision has been held not to satisfy the requirements of section 523(a)(4). *See e.g., Medved v. Novak*, (In re Novak), 97 B.R. 47 (Bankr.D.Kan.1987).

Only one circuit court has addressed the issue of the fiduciary obligations of a partner in the context of a section 523(a)(4) claim. In the case of *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir.1986), the Ninth Circuit held that, under California law, the partners in a partnership did owe one another the type of fiduciary duty contemplated by section 523(a)(4). *Id.*, at 796-97. The court found that, while the California partnership statute only created a trust *ex maleficio*, the California state courts had imposed additional duties on the partners in a partnership:

> In California, partners are trustees for each other and in all proceedings connected with the conduct of the partnership every partner is bound to act in the highest good faith to his co-partner and may not obtain any advantage over him in the partnership affairs by the slightest misrepresentation, concealment, threat or adverse pressure of any kind.

Id. at 796. (Quoting *Leff v. Gunter*, 33 Cal.3d 508, 514, 658 P.2d 740, 744, 189 Cal.Rptr. 377, 381 (1983)). The court concluded that the obligations imposed by the California courts were "more than just a fiduciary relationship created in response to some wrongdoing; California has made all partners trustees over the assets of the partnership." *Id.* As a result, the court held that the debtor's debt to his partner was not dischargeable.[9] *Id.*

The *Hurbace* court declined to follow the *Ragsdale* decision, finding that the Texas courts had not imposed the same type of fiduciary duties on partners as the California courts. *In re Hurbace*, 61 B.R. at 566. The court observed that:

> It is only when viewing the position of managing partners do Texas courts venture to impose the type of fiduciary duty described in *Ragsdale*. (Citations omitted).

Id. The court concluded:

> . . . in the present case dealing not with a managing partner vis-a-vis general partners but with equal co-partners, the scope of fiduciary duty described in *Ragsdale* is not applicable . . . [and] . . . § 523 (a)(4) insofar as it relates to a debtor acting in a fiduciary capacity does not apply to the failure of partners to account.

Id. Therefore, the court in *Hurbace* held that under Texas law, there was not a sufficient fiduciary duty between equal co-partners of a general partnership to satisfy the requirements of section 523(a)(4).

However, the case at bar does not involve equal co-partners, as the *Hurbace* case did. In this case the Court

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[9] Subsequently, the Ninth Circuit held that, under Washington law, partners were also fiduciaries for purposes of section 523 (a)(4). *Lewis v. Short* (In re Short), 818 F.2d 693, 695-96 (9th Cir. 1987).

must decide first whether, under Texas law, the scope of fiduciary duty owed by a general partner to limited partners meets the express trust requirements of section 523 (a)(4), and second, whether such a duty exists for or can be imputed to the managing partner of the managing partner.

The Appellants argue that the Texas courts have long held that a partner in complete control of a partnership, whether the general partner of a limited partnership or the managing partner of a general partnership, owes one of the highest fiduciary duties known at law to his partners. The Appellee, on the other hand, relying on the opinion of the district court, argues that, while the Texas courts have imposed a very high level of fiduciary duty on managing partners, they have done so only in the context of constructive trusts and, therefore, by definition these obligations are insufficient to meet the express trust requirements of the bankruptcy discharge provisions.[10]

The Texas Supreme Court case of *Huffington v. Upchurch,* 532 S.W.2d 576 (Tex. 1976), is generally cited as the primary authority for the imposition of trustee-like duties on the managing partner of a partnership. The *Huffington* case did involve the imposition of a constructive trust. *Id.* at 577. Likewise, the two cases cited by the court in *Huffington* in support of the proposition that managing partners owe the highest level of fiduciary obli-

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[10] In support of its holding, the district court relied in part on the case of *CRL of Maryland, Inc. v. Holmes,* 117 B.R. 848 (Bankr. D.Md. 1990). The court in *Holmes* held that a statutory trust cannot be a technical trust for purposes of section 523(a)(4) in the absence of the execution of a formal trust agreement between the parties because the creation of an express trust depends upon the intention of the parties and can never be created by statute alone. *CRL of Maryland, Inc. v. Holmes,* 117 B.R. at 853. This Circuit has not taken such a technical approach to the interpretation of section 523(a)(4), *see e.g. Moreno v. Ashworth,* 892 F.2d 417, 421 (5th Cir. 1990), and does not find that such an approach is warranted in this case.

gation to their co-partners, were also constructive trust cases. *See Smith v. Bolin*, 153 Tex. 486, 271 S.W.2d 93 (1954); *MacDonald v. Follett*, 142 Tex. 616, 180 S.W.2d 334 (1944).

However, contrary to Bennett's contention, this principle has not been limited to cases involving constructive trusts. In *Cook v. Peacock*, 154 S.W.2d 688 (Tex.Civ. App.—Eastland 1941, writ ref'd w.o.m.), a case involving an action for a partnership accounting, the court observed that "[t]he duty of a partner in control of . . . a business is analogous to that of a trustee." *Id.*, at 691. *See also Conrad v. Judson*, 465 S.W.2d 819, 828 (Tex. Civ.App.—Dallas 1971, writ ref'd n.r.e.), *cert. denied*, 405 U.S. 1041, 92 S.Ct. 1312, 31 L.Ed.2d 582 (1972); *Johnson v. Buck*, 540 S.W.2d 393, 412-13 (Tex.Civ.App. —Corpus Christi 1976, writ ref'd n.r.e.); *Cf. Johnson v. J. Hiram Moore Ltd.*, 763 S.W.2d 496, 499 (Tex. App.—Austin 1988, writ denied); *Veale v. Rose*, 657 S.W.2d 834, 837 (Tex.App.—Corpus Christi 1983, writ ref'd n.r.e.).

In *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex.Civ.App.—Austin 1978, writ ref'd n.r.e.), a case brought for breach of fiduciary duty, the court held:

> In a limited partnership the general partner, acting in complete control, stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of the trust. (Citations omitted).

Id., at 182. And in the *Crenshaw* case, discussed at length below, the court stated:

> It is axiomatic that a managing partner in a general partnership owes his co-partners the highest fiduciary duty recognized in the law.

Crenshaw v. Swenson, 611 S.W.2d 886, 890 (Tex.Civ. App.—Austin 1980, writ ref'd n.r.e.).

This Court has previously observed, in deciding whether tax attributes associated with certain commercial real estate should be attributed to a corporation or a partnership, that the duty a general partner owes to limited partners is analogous to that owed by a trustee to trust beneficiaries. *Moncrief v. United States*, 730 F.2d 276, 285 (5th Cir.1984) (Citing *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.)).

Further, in *Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir.1990), we held that the debtor, who was an officer of a corporation, owed a fiduciary duty to that corporation and its stockholders. We found that because the debtor had entered into certain self-dealing transactions while an officer of the corporation, the debts arising from these transactions were not dischargeable under the provisions of 11 U.S.C. § 523(a)(4). *Id.* Because the role of an officer or director of a corporation with respect to the shareholders is analogous to the role of managing partner of a limited partnership with respect to the limited partners, *Moreno*, by analogy, supports the argument that the managing partner of a limited partnership owes a sufficient fiduciary duty to the limited partners to satisfy the requirements of section 523(a)(4).

Significantly, the specific duties imposed by the Texas courts on managing partners pursuant to this line of cases are the same as those imposed on trustees. They include the duty of loyalty, *Huffington*, 532 S.W.2d at 579, and the duty to "deal with one another with the utmost good faith and most scrupulous honesty." *Johnson*, 763 S.W.2d at 499. As the court in *Crenshaw* stated, when a general partner is in complete control of the assets and affairs of a limited partnership:

> [His] conduct must be measured by standards exacting the utmost fidelity. . . . Not only is it [the general partner's] duty to administer the partnership affairs solely for the benefit of the partnership, he is

> not permitted to place himself in a position where it would be for his own benefit to violate this duty.

Crenshaw, 611 S.W.2d at 890.

We find, as the Ninth Circuit did in *Ragsdale*, that these obligations are more than a fiduciary relationship created in response to some wrongdoing. Texas law clearly and expressly imposes trust obligations on managing partners of limited partnerships and these obligations are sufficient to meet the narrow requirements of section 523(a)(4).

However, this is only the first step in the analysis, because it is undisputed that Bennett was not the managing partner of MG. He was instead, the managing partner *of the managing partner* of MG. Therefore, this Court must now address the more difficult question of whether Texas law imposes these same trust-type obligations on the managing partner in a two-tiered partnership arrangement, i.e. the managing partner of the managing partner.

In support of their argument that Bennett did owe a trustee's fiduciary obligation to the limited partners of MG, the Appellants rely on the case of *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.). They argue that both the facts and the court's analysis in that case support the proposition that under Texas law a general partner of a general partner of a limited partnership owes a fiduciary duty of loyalty to the limited partners. Because *Crenshaw* is the only case that arguably supports the Appellants' contention it merits further discussion.

The *Crenshaw* case was a suit for breach of fiduciary duty, and involved a limited partnership known as Rolling Hills Majestic Homes (Group I), Ltd. This limited partnership was formed for the purpose of constructing and selling four homes in Austin, Texas. The general partner of this limited partnership was another partnership, known as Occidental Syndicated Investments (Occidental). The original partners in Occidental were Elizabeth Swenson,

Robert Johnson and James Cooper. *Id.*, at 888. Elizabeth Swenson, the defendant in the *Crenshaw* case, was therefore a general partner of the general partner of a limited partnership; a relationship clearly analogous to that of Archie Bennett vis-a-vis the MG limited partnership.

In *Crenshaw*, the limited partnership agreement provided that the limited partners would contribute capital to the partnership, a portion of which was to be used to purchase tracts of land for development. Title to these facts was held by Swenson Corporation, a corporation wholly owned by Elizabeth Swenson and her husband, Vernor Swenson. After the lots were purchased from Swenson Corporation, the limited partnership attempted to obtain a construction loan to finance the building of houses on the lots. The lender refused to make the loan to the limited partnership, but agreed to lend the money to Swenson Corporation. As a result, the lots were transferred back to the Swenson Corporation so that the property could be used as security for the construction loan. *Id.*

Subsequently, a variety of problems developed with respect to the construction and sale of the houses. The partnership sustained losses, and the limited partners were left empty-handed and disgruntled. The limited partners then brought suit against Elizabeth Swenson for breach of fiduciary duty. *Id.* at 888-889.

The *Crenshaw* court decided the case based on the law of trusts stating:

> It is axiomatic that a managing partner in a general partnership, owes his co-partners the highest fiduciary duty recognized in the law. In a limited partnership, the general partner acting in complete control stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of the trust. We must then, in deciding this case, do so under the laws applicable to trusts.

Crenshaw, 611 S.W.2d at 890. The court phrased the legal issue as whether "the trial court erred in failing to find that appellee, Elizabeth Swenson, breached her fiduciary duty of loyalty to the partnership and to the limited partners." *Id.*

The court reviewed the particular facts of the case and observed that, "a conveyance of partnership property was made and the proceeds from the sale . . . were deposited in the Swenson Corporation . . . without the knowledge or consent of [the limited partners]". *Id.*, at 891. The court also noted that, "the Swenson Corporation was the general contractor in absolute control of the partnership's destiny and . . . Elizabeth Swenson had the right to the exclusive listing when the finishd product was sold . . ." *Id.* Taking these facts together, the court concluded that "the case takes on an aura of self-dealing which this Court is unable to condone." *Id.* The court then held that Ms. Swenson had breached her fiduciary duty of loyalty to the limited partners as a matter of law, and that these limited partners were entitled to equitable restitution of their investment in the limited partnership. *Id.*

The Appellants assert that because Elizabeth Swenson was a general partner of the general partner of the limited partnership, and because the appellate court held that she owed the limited partners the fiduciary obligations of a trustee, the case stands for the proposition that under Texas law a general partner of a general partner owes fiduciary responsibilities directly to the underlying limited partners.

Bennett disagrees with the Appellants' interpretation of *Crenshaw*. He argues that *Crenshaw* is distinguishable because,

> [W]hen all of the other general partners of Occidental Syndicated Investments resigned from the partnership, that action effected a dissolution of the separate partnership entity leaving only Swenson to

> act in an individual capacity as the general partner of the limited partnership.

Brief of Appellee Archie Bennett, Jr., at pp. 18-19.

While the court in *Crenshaw* does note that "[s]ubsequent to the execution of the partnership agreement, both Robert Johnson and James Cooper resigned as general partners," it does not indicate *when* this occurred. *Crenshaw,* 611 S.W.2d at 888. Nor does the court suggest anywhere in its opinion that this fact was relevant to the conclusions it reached. In fact, in describing the critical transfer of property that forms the basis for the conclusion that Elizabeth Swenson breached her fiduciary duty to the limited partners, the court states that "the general *partners* transferred title to the lots back to the Swenson Corporation. . . ." *Id.* This indicates that, at least at the time the alleged breach occurred, Ms. Swenson was not acting individually as the general partner of the limited partnership. To the contrary, the statement that the "general partners transferred title . . ." indicates that the transfer was effected by Occidental, as the general partner of the limited partnership. Therefore, Bennett's attempt to distinguish *Crenshaw* is not persuasive.

What this Court finds significant is the *Crenshaw* court's analysis of why the managing partner of the managing partner in that case owed a fiduciary obligation to the underlying limited partners. In analyzing the duties that Ms. Swenson owed to the limited partners, the *Crenshaw* court focused on the nature of the business relationship as a whole, in which one person, Elizabeth Swenson, in her various roles as general partner of the general partner, owner of the corporation hired to accomplish the construction project, and the real estate broker authorized to sell the properties when completed, exercised almost total control over the project. This high level of control, over the project and the limited partners' investments, appears to have been critical in persuading the *Crenshaw* court that Ms. Swenson owed a fiduciary duty to the limited partners.

In reviewing the line of cases that gave rise to the rule in Texas that the managing partner of a partnership owes to his copartners the highest fiduciary obligations known at law, it is clear that the issue of control has always been the critical fact looked to by the courts in imposing this high level of responsibility.

In *Huffington v. Upchurch,* 532 S.W.2d 576 (Tex. 1976), the case generally cited as establishing the common law rule in Texas that the managing partner of a partnership owes to his copartners one of the highest fiduciary duties recognized at law, the Texas Supreme Court cited three cases in support of its holding: *Smith v. Bolin,* 153 Tex. 486, 271 S.W.2d 93 (1954), *MacDonald v. Follett,* 142 Tex. 616, 180 S.W.2d 334 (Tex. 1944), and *Meinhard v. Salmon,* 249 N.Y. 458, 164 N.E. 545 (1928).

Smith v. Bolin involved a partnership in which the respondent, Bolin, was the "business manager". *Smith v. Bolin,* 271 S.W.2d at 94. Bolin, individually, had entered into renewal leases of certain oil and gas properties that had previously been leased by the partnership. He was sued by his partners for breach of fiduciary duty. The parties disagreed about whether the partnership was still in existence at the time Bolin entered into the disputed transactions, but the court, in reversing the summary judgment granted to Bolin by the trial court, quoted extensively from the opinion in *Meinhard v. Salmon,* and held that "[a]s managing partner of their partnership enterprise, respondent owed his partners even a greater duty of loyalty than is normally required." *Id.,* 271 S.W.2d at 96. The critical fact underlying this "greater duty of loyalty than is normally required," was the greater degree of control that one partner (i.e., the managing or business partner) had over the operation of the partnership and hence the investment of the other partners.

Likewise, in *Meinhard v. Salmon,* a case cited extensively in Texas and elsewhere for establishing the funda-

mental fiduciary duty rules governing managing partners, Justice Cardozo focused on the control that one "coadventurer" exercised over the business enterprise at issue:

> The very fact that Salmon was in control with exclusive powers of direction charged him the more obviously with the duty of disclosure . . .

Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 547 (1928). The court observed:

> [T]here may be no abuse of special opportunities growing out of a special trust as manager or agent. . . . Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation. He was much more than a coadventurer. He was a managing coadventurer. For him and for those like him the rule of undivided loyalty is relentless and supreme. (Citations omitted).

Id., 164 N.E. at 548. Therefore, again in the *Meinhard* case the fact of control or management is vital to the court's analysis.[11]

The *Crenshaw* court, analyzing the issue in a manner consistent with the way in which Texas jurisprudence has developed in this area, concluded that Ms. Swenson, the

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[11] The Court located only one other case in which an issue similar to the one at bar was decided in a bankruptcy context. In *Park v. Moorad*, 132 B.R. 58 (Bankr.Okla. 1991), the debtor was the president, director and sole shareholder of a corporation, which in turn was the general partner of a limited partnership. *Id.* at 60. At issue in *Park* was whether the debtor as an individual should be granted a discharge of debts owed by the corporation to the limited partners. The bankruptcy court was not persuaded by the argument that only the corporation as the managing partner owed a fiduciary duty to the limited partners and denied the discharge, under section 523(a)(4), stating that the debtor would not be allowed to "hide beneath a corporate shell when he so completely controlled the corporate actions, representations and decisions that in effect it had no life without him." *Id.* at 63. Once again, the court focused on the control exercised by one person over the investments of others.

managing partner of the managing partner of the limited partnership, owed to the limited partners the highest fiduciary duty known at law, a duty analogous to that owed by a trustee to the beneficiaries of the trust. *Crenshaw*, 611 S.W.2d at 890. Therefore, based on the holding in *Crenshaw* and the cases cited therein, we find that Bennett, as the managing partner of the managing partner, owed to the MG limited partners "the highest fiduciary duty recognized in the law." We find further that this fiduciary obligation is sufficient to meet the requirements of Section 523(a)(4).

3. *Defalcation and Damages.*

A defalcation is a willful neglect of duty, even if not accompanied by fraud or embezzlement. *Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir.1990). Therefore, any debts incurred by Bennett as a result of the willful neglect of his duties as the managing partner of the managing partner of the MG limited partnership are not dischargeable. 11 U.S.C. § 523(a)(4).

The Appellants argue that the bankruptcy court erred in its determination of the amount of Bennett's non-dischargeable debt in several ways. First, they argue that the court erred in calculating the amount of debt not dischargeable based on actual damages (i.e. based on specific defalcations found by the bankruptcy court) instead of granting them restitution of their entire investment. This argument is without merit. While restitution is a permissible method of recovery for breach of fiduciary duty, it is not the only one. *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179, 182 (Tex.Civ.App.—Austin 1978, writ ref'd n.r.e.). Actual damages are also a permissible remedy for breach of fiduciary duty, *Preston Carter Co. v. Tatum*, 708 S.W.2d 23 (Tex.App.—Dallas 1986, writ ref'd, n.r.e.), as is a suit for an accounting and exemplary damages, *Manges v. Guerra*, 673 S.W.2d 180 (Tex.1984). We find that the method the bankruptcy court employed to calculate Bennett's non-dischargeable

debt in this case was permissible under Texas law, and therefore, was not error.

In accordance with the findings and calculations of the bankruptcy court, $72,000 worth of repairs on the HVAC system and $832,204.40 worth of equipment leases were improperly charged to the limited partners. By making these improper charges Bennett willfully neglected his duties to the limited partners and we find that these charges constitute defalcations by Bennett while acting in a fiduciary capacity, and as such are not dischargeable pursuant to 11 U.S.C. § 523(a)(4).

The Appellants also argue that the bankruptcy court exceeded its authority in calculating damages at all, since the Appellants were only seeking a ruling on the dischargeability of the debt in the adversary proceeding. This contention is also without merit. It is customary for a bankruptcy court to determine both liability and the measure of damages in a proceeding to determine the dischargeability of a debt. *See e.g. Jordan v. Southeast National Bank* (Matter of Jordan), 927 F.2d 221 (5th Cir.1991); *Shaver Motors, Inc. v. Mills* (In re Mills), 111 B.R. 186 (Bankr.N.D.Ind.1988); *Medved v. Novak* (In re Novak), 97 B.R. 47 (Bankr.D.Kans.1987). In addition, in their Complaint to Determine Dischargeability of Debt, the Appellants asked the bankruptcy court to enter judgment for them in the full amount of their investment. Thus, the issue of the amount of debt not dischargeable was properly before the bankruptcy court and it was not error for it to rule on that issue.

Finally, the Appellants argue that the bankruptcy court erred in failing to find that the $1 million distribution to Bennett was also a defalcation. On this point we agree with the Appellants. Under Texas law, a fiduciary who breaches his duties forfeits his right to compensation as a matter of law. *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 514 (1942); *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d

312, 318 (Tex.App.—Tyler, 1985, no writ); *Anderson v. Griffith,* 501 S.W.2d 695, 702 (Tex.Civ.App.—Fort Worth 1973, writ ref'd n.r.e.). In addition, it was an act of self dealing and a breach of the duty of good faith and fair dealing for Bennett to have paid himself the $1 million distribution when at the same time he improperly charged more than $800,000 in equipment leases to the limited partners. Thus, the $1 million distribution was also a defalcation by Bennett and is not dischargeable pursuant to 11 U.S.C. § 523(a)(4).

Conclusion

In conclusion, we find that the question of the nondischargeability of Bennett's debts to the limited partners under 11 U.S.C. § 523(a)(4) was wrongly decided. We therefore reverse the decisions of the bankruptcy and district courts on that issue and render judgment in favor of the limited partners in the amount of $1,904,204.40.

REVERSED and RENDERED.

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, AND JOE E. MCLEMORE,

Appellants,

v.

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court
for the Northern District of Texas

Sept. 2, 1992

D. Mitchell McFarland, Cynthia L. Osborn, Paul L. Alpern, Liddell, Sapp, Zivley, Hill & Laboon, Houston, Tex., for appellants.

Lenard M. Parkins, Patrick L. Hughes, Sheinfeld, Maley & Kay, Houston, Tex., for appellee.

Before POLITZ, Chief Judge, and HIGGINBOTHAM, Circuit Judge, and PRADO, District Judge: [1]

PRADO, District Judge:

This appeal arises out of an adversary proceeding in a bankruptcy case,[2] in which the bankruptcy court entered an order granting a discharge to the Appellee, Archie Bennett, Jr., over the objection of the Appellants that certain of Mr. Bennett's debts were not dischargeable. In support of their argument, the Appellants rely solely on 11 U.S.C. § 523(a)(4), which provides that debts resulting from a defalcation by the debtor while acting in a fiduciary capacity are not dischargeable in bankruptcy. This Court must decide whether Bennett, as the managing partner of the managing partner of the limited partnership, owed a sufficient fiduciary duty to the limited partners to satisfy the strict requirements of 11 U.S.C. § 523 (a)(4). This is a case of first impression in this Circuit.

Standard of Review

Although this case has already been reviewed on appeal by the district court, this Court reviews the bankruptcy court's findings as if this were an appeal from a trial in the district court. *Killebrew v. Brewer,* 888 F.2d 1516, 1519 (5th Cir.1989). Thus, the bankruptcy court's findings of fact are reviewed under the clearly erroneous standard, and its conclusions of law are reviewed *de novo. Id.*

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[1] District Judge of the Western District of Texas, sitting by designation.

[2] The underlying bankruptcy proceeding, filed on November 23, 1988, by Archie Bennett, Jr., bears Case No. 388-37142 RCM-7. The adversary proceeding is No. 389-3110.

Background

1. *Bankruptcy Court's Findings of Fact.*

The facts in this case are essentially undisputed.[3] In approximately March of 1980, Bennett and the Appellants formed a Texas limited partnership known as Mariner/Greenspoint, Ltd. ("MG"). The Appellants in this case are and were at all relevant times, limited partners of MG. The sole general partner of MG was another limited partnership, known as Mariner Interest No. 20, Ltd. ("No. 20"). The sole general partner of No. 20 was the Appellee, Archie Bennett, Jr.

Under the terms of the MG partnership agreement, the general partner, No. 20, was charged with management of the partnership and had full, exclusive and complete authority and discretion to manage, control and make all decisions affecting the purposes of the partnership and to take any action required to effectuate the purpose of the partnership. Bennett, as the sole general partner of No. 20, was the only individual with the power or authority to direct the affairs of No. 20 and MG, and was prohibited by the MG partnership agreement from voluntarily withdrawing as the general partner of No. 20.

The purpose of the MG partnership was to construct and operate a Marriott hotel near the Greenspoint Mall in Houston, Texas. The partnership obtained $22 million, in capital contributions and loans, to cover the cost of constructing the hotel. The MG partnership agreement required the general partner to contribute cash, as neecs-

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[3] The Appellee expressly states that he relies on the bankruptcy court's findings of fact. Appellee's Brief, p. 3. With one partial exception, the Appellants agree that the bankruptcy court's findings of fact are correct. Appellants' Brief, p. 7. The exception, discussed below, is the Appellants' argument that the bankruptcy court erred in failing to find that the $1 million distribution by M/G to Bennett was a defalcation under 11 U.S.C. § 523(a)(4). *Id.* This is a mixed question of law and fact.

sary, for the costs of constructing, equipping and furnishing the hotel, to the extent such costs exceeded the $22 million previously raised. As an incentive, the agreement also provided that the general partner was eligible to receive a cash distribution of up to $4 million if the project was completed for less than the projected $22 million. However, prior to taking any distribution for savings in the construction of the hotel, the general partner was required both to construct the hotel and to provide all equipment necessary so that it could operate as a "first-class hotel".

At some point early on in the business venture, Bennett retained a corporation, known as Mariner Corporation, to perform his duties as the general partner of No. 20 and, in turn, its duties as general partner of MG. Mariner Corporation was 100% owned by Bennett. The officers and employees of Mariner Corporation acted on Bennett's behalf in performing their duties and were aware that, if the project was completed under budget, the savings would be paid directly to Bennett.

Mariner Corporation obtained bids for the construction of the hotel from a number of general contractors. All of the bids initially submitted were at least $1 million over the budgeted amount of $22 million. After these bids were received, Mariner Corporation entered into negotiations with one of the contractors, Eaves Construction. Subsequently, Eaves dropped its bid price by $1 million and was awarded the contract. Eaves was not able to obtain a bond on the project, however, due to its lack of financial strength and lack of a sufficient track record on large projects. Bennett told Eaves that it could have the job without a bond, if it reduced its general contractor's fees by one-half. Eaves agreed and reduced its fee by an additional $250,000.

The hotel was completed on time, and opened in January of 1981. At that time Bennett made a $1 million distribution to himself, for completing the project for less than the budgeted $22 million.

Subsequently, several problems with the hotel came to light. First, in approximately April of 1981, mildew began to occur in the guest rooms of the hotel. This mildew was evidently caused by a "negative pressure" problem, which in turn was caused by the design of the heating, ventilation, and air conditioning (HVAC) system in the hotel.[4] As a result of the mildew problem, virtually all of the guest rooms in the hotel had to be revinyled and resheetrocked twice, during 1981 and 1982.[5]

The bankruptcy court found that the mildew problem at the hotel was a continuous construction problem that the general partner had an obligation to fix and pay for under the terms of the MG partnership agreement. The court found that the first round of repairs was performed at the expense of the general contractor. The second round, however, was charged, by the general partner, to the partnership earnings. The limited partners' share of this cost was $72,000.

The bankruptcy court also reviewed numerous equipment leases that were entered into by the general partner for the purpose of providing various types of equipment to the hotel. The court found that, under the partnership agreement, the general partner had an obligation to equip and furnish the hotel with the $22 million budgeted amount. The court found, with respect to some but not all of these leases, that the general partner had charged them to the partnership, instead of paying for them out of the construction budget. The court also found that

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[4] "Negative pressure" in a building occurs when more air is exhausted from the building than is made up with conditioned air. The result is that warm, humid air will be drawn into the building to equalize the pressure.

[5] The record indicates that, prior to completion of the hotel, in November of 1980, Bennett was made aware that another Marriott hotel, the Brookhollow Marriott, which had substantially the same HVAC system design as the Greenspoint Marriott, had begun to experience similar mildew problems.

Bennett had failed to properly disclose these leases to the limited partners, or to obtain their approval for them. The court determined that the amount wrongfully charged to the limited partners for these equipment leases was $832,204.40.

2. *Bankruptcy Court's Conclusions of Law.*

The bankruptcy court concluded that the misapplication of partnership funds to pay for the mildew repairs and the equipment leases described above were the result of defalcations by the general partner of MG in the total amount of $904,204.40. The court also found that No. 20, as the sole general partner of MG, was a fiduciary to the limited partners of MG, for purposes of section 523(a)(4). The bankruptcy court noted that while Texas courts have not extended the partnership relationship generally to encompass the type of fiduciary duty envisioned by section 523(a)(4), an exception exists for the managing partner of a partnership, who owes to his co-partners, "one of the highest fiduciary duties recognized in law." (Citing *Huffington v. Upchurch,* 532 S.W.2d 576 (Tex.1976); *Crenshaw v. Swenson,* 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.)).

The bankruptcy court also found, however, that Bennett, as the general partner of the general partner, did not owe a fiduciary duty to the limited partners of MG. The bankruptcy court stated:

> No. 20 was the fiduciary of MG and only it had an express, technical, preexisting trust relationship with MG, even though Bennett was the managing partner of No. 20.

The bankruptcy court found that Bennett's individual liability to the limited partners of MG came into effect only by reason of the breach by No. 20, and pursuant to the Uniform Partnership Act (UPA) which provides, "[a]ll partners are liable jointly and severally for all debts, and obligations of the partnership. . . ." Tex.Rev.Civ.

Stat. Ann. art. 6132b, § 15 (Vernon 1979). The court reasoned that while the UPA made Bennett liable for No. 20's partnership "obligations", it did not create a fiduciary relationship between Bennett and the limited partners of MG. Accordingly, the bankruptcy court granted a discharge to Bennett of all debts, including those which it found to have resulted from defalcations by No. 20, while acting in a fiduciary capacity.

3. *The District Court's Order.*

The district court, in a brief opinion, affirmed the order of the bankruptcy court granting a discharge to Bennett, but for a different reason. The district court stated:

> Though Bennett was the managing partner of the limited partnership, and Texas courts have imposed a higher degree of fiduciary duty on managing partners, they have done so in the context of constructive, rather than technical, trusts. (Citing *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex.1976); *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.)).

Thus, the district court concluded that the high level of fiduciary duty imposed on managing partners of a partnership under Texas law, only arose in the context of a constructive trust and, since constructive trusts are insufficient as a matter of law to meet the express trust requirements of section 523(a)(4), the district court affirmed the order of the bankruptcy court granting a discharge to Bennett.

Analysis

1. *Fiduciary Duty Under Section 523(a)(4)*

The Bankruptcy Code provides in pertinent part as follows:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

> (4) for fraud or defalcation while acting in a fiduciary capacity. . . .

11 U.S.C. § 523(a)(4).

The first issue that we address is whether the scope of the fiduciary duty owed by the managing general partner of a limited partnership to the limited partners is sufficient to meet the narrow requirements of section 523(a)(4). Next, we must decide if such a duty also applies to the managing partner of the managing partner.

A number of courts have addressed the issue of whether a partner generally owes the type of fiduciary duty contemplated by section 523(a)(4) to his co-partners. The courts are split on this issue with approximately half finding that such a fiduciary duty is owed,[6] and the other half

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[6] *See, e.g., Lewis v. Short* (In re Short), 818 F.2d 693, 695-96 (9th Cir. 1987) (Washington law); *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986) (California law); *Longo v. McLaren* (In re McLaren), 136 B.R. 705, 714 (Bankr.N.D. Ohio 1992); *Gravel v. Chris J. Roy, A Law Corp.* (In re Chris J. Roy), 130 B.R. 214 (Bankr.W.D.La. 1991); *Beebe v. Schwenn* (In re Schwenn), 126 B.R. 351 (D.Colo. 1991); *Getaz v. Stewart* (In re Stewart), 123 B.R. 817 (Bankr.W.D. Tenn. 1991); *Braun v. McKay* (In re McKay), 110 B.R. 764 (Bankr.W.D.Pa. 1990); *Susi v. Mailath* (In re Mailath), 108 B.R. 290, 293-94 (Bankr.N.D.Okla. 1989); *In re Guy*, 101 B.R. 961, 986-91 (Bankr.N.D.Ind. 1988) *In re Cramer*, 93 B.R. 764, 767-68 (M.D.Fla. 1988) *Lee v. Crosswhite* (In re Crosswhite), 91 B.R. 156 (Bankr.M.D. Fla. 1988); *Stone v. Stone* (In re Stone), 90 B.R. 71, 79-80 (Bankr.S.D.N.Y.), *aff'd*, 94 B.R. 298, 302-03 (S.D.N.Y. 1988), *aff'd*, 880 F.2d 1318 (2nd Cir. 1989); *In re Dino*, 82 B.R. 184, 186 (Bankr.D.R.I. 1988); *In re Owens*, 54 B.R. 162, 164-65 (Bankr.D.S.C. 1984); *In re Kraus*, 37 B.R. 126, 129 (Bankr.E.D.Mich. 1984). *See also In re Weiner*, 95 B.R. 204, 206-07 (Bankr.D.Kansas 1989) (although no fiduciary relationship between partners generally, the sole managing partner had responsibilities commonly associated with trustee and was therefore a fiduciary under section 523(a)(4)); *In re Hurbace*, 61 B.R. 563, 565-66 (Bankr.W.D.Tex. 1986) (holding that there was insufficient fiduciary relationship between equal copartners to meet requirements of section 523(a)(4), but indicating, in dicta, that managing partner's fiduciary duties probably sufficient).

finding that it is not.[7]

The seminal case in this Circuit interpreting the discharge provision at issue is *Angelle v. Reed* (In re Angelle), 610 F.2d 1335 (5th Cir.1980).[8] In *Angelle* we reviewed a line of Supreme Court cases discussing and interpreting similar discharge provisions contained in prior versions of the bankruptcy laws. We held that the concept of fiduciary under 11 U.S.C. § 523(a)(4) is narrowly defined, applying only to technical or express trusts, and not those which the law implies from the contract. *Id.*, (quoting *Chapman v. Forsyth*, 43 U.S. (2 How.) 202, 207, 11 L.Ed. 236, 238 (1844)). In addition, the requisite trust relationship must exist prior to the act creating the debt and without reference to that act. *Id.*, (citing *Upshur v. Briscoe*, 138 U.S. 365, 378, 11 S.Ct. 313, 317, 34 L.Ed. 931, 936 (1890)). In other words, the trust giving rise to the fiduciary relationship must be imposed prior to any wrongdoing. The debtor must have

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[7] *Rolley v. Spector* (In re Spector), 133 B.R. 733 (Bankr.E.D. Penn. 1991); *Blashke v. Standard* (In re Standard), 123 B.R. 444 (Bankr.N.D.Ga. 1991); *Sulphur Partnership v. Piscioneri* (In re Piscioneri), 108 B.R. 595 (Bankr.N.D.Ohio 1989); *Stahl v. Lang* (In re Lang), 108 B.R. 586 (Bankr.N.D.Ohio 1989); *Coleman v. Choisnard* (In re Choisnard), 98 B.R. 37 (Bankr.N.D.Okl. 1989); *Medved v. Novak*, (In re Novak), 97 B.R. 47 (Bankr.D.Kan. 1987); *In re Lewis*, 94 B.R. 406, 410 (Bankr.E.D.Va. 1988); *In re Stone*, 91 B.R. 589, 594 (D.Utah 1988); *Dreyfoos v. Ryan* (In re Ryan), 90 B.R. 554 (Bankr.S.D.Fla. 1988); *In re Braudis*, 86 B.R. 1001, 1004 (Bankr.W.D.Mo. 1988); *In re Clemens*, 83 B.R. 945, 951 (Bankr.N.D.Ohio 1988); *In re Napoli*, 82 B.R. 378, 382-83 (Bankr. E.D.Pa. 1988); *In re Elliott*, 66 B.R. 466, 467 (Bankr.S.D.Fla. 1986); *In re Holman*, 42 B.R. 848, 850-51 (Bankr.E.D.Mo. 1984).

[8] In the *Angelle* case we construed section 17a(4) of the former Bankruptcy Act, 11 U.S.C. § 35(a)(4). We have previously noted that while the language of section 523(a)(4) does not precisely parallel that of the predecessor statute, 11 U.S.C. § 35(a)(4), the two statutes are similar enough that decisions construing the prior statute are applicable to section 523(a)(4). *Boyle v. Abilene Lumber, Inc.*, 819 F.2d 583, 587 (5th Cir. 1987).

been a trustee before the wrong and without any reference to it. *Ragsdale v. Haller,* 780 F.2d 794, 796 (9th Cir. 1986). Thus, a constructive trust is not sufficient to create a fiduciary relationship for purposes of the discharge provisions of the Bankruptcy Act. *Angelle,* 610 F.2d at 1339; *Ragsdale,* 780 F.2d at 796.

In determining whether a particular debtor was acting in a fiduciary capacity for purposes of section 523(a)(4), the Court must look to both state and federal law. The scope of the concept of fiduciary under 11 U.S.C. § 523 (a)(4) is a question of federal law; however, state law is important in determining whether or not a trust obligation exists. *Angelle,* 610 F.2d at 1339.

There has been some disagreement among the courts as to what exactly is meant by the requirement that there be a "technical trust" to satisfy section 523(a)(4). Most courts today, however, recognize that the "technical" or "express" trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law. *See e.g. Moreno v. Ashworth,* 892 F.2d 417, 421 (5th Cir.1990) (officer of a corporation owed common law fiduciary duty to corporation and stockholders sufficient to satisfy requirements of section 523(a)(4)); *Lewis v. Short* (In re Short), 818 F.2d 693, 695-96 (9th Cir.1987) (Washington common law imposed trustee-like duties on partners of partnership); *Ragsdale v. Haller,* 780 F.2d 794, 796 (9th Cir.1986) (California common law imposed trustee-like duties on all partners of a partnership); *Carey Lumber Company v. Bell,* 615 F.2d 370, 374 (5th Cir.1980) (Oklahoma Lien Trust statutes created an express trust). Thus, the trust obligations necessary under section 523 (a)(4) can arise pursuant to a statute, common law or a formal trust agreement.

2. *Fiduciary Duties of Managing Partners Under Texas Law.*

The controlling law in this case is Texas law. Therefore, this Court must look to Texas law in order to determine what obligations are imposed on the managing general partner of a limited partnership with respect to the limited partners. The Court must then decide whether the obligations imposed under state law are sufficient to meet the federal law requirements of "fiduciary capacity" under section 523(a)(4).

In addressing this issue, both the bankruptcy court and the district court below referred to and relied on the case of *In re Hurbace,* 61 B.R. 563 (Bankr.W.D.Tex.1986). In that case, involving a general partnership, the court addressed the issue of whether the debtor should be denied a discharge under section 523(a)(4) for a judgment entered against him in state court for his failure to account to one of his former partners for certain partnership funds. *Id.* at 564-65. The *Hurbace* court looked to the Texas version of the Uniform Partnership Act (UPA), in order to determine whether the requisite trust relationship existed for purposes of section 523(a)(4). The court focused on the following language:

> Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

Tex.Rev.Civ.Stat.Ann. art. 6132b, § 21 (Vernon 1979). The court stated that the phrase "hold as trustee" did not establish a technical or express trust for purposes of section 523(a)(4). More to the point, the court found that, "[u]nder the Texas statute, the trust arises only when the partner derives profits without the consent of the other

partners. Therefore, the statute would fall within the ambit of a trust *ex maleficio* specifically excluded from the purview of nondischargeable debts under § 523 (a)(4)." *In re Hurbace,* 61 B.R. at 566. The *Hurbace* court's interpretation of the UPA is in accord with those decisions cited above in which this UPA provision has been held not to satisfy the requirements of section 523 (a)(4). *See e.g., Medved v. Novak,* (In re Novak), 97 B.R. 47 (Bankr.D.Kan.1987).

Only one circuit court has addressed the issue of the fiduciary obligations of a partner in the context of a section 523(a)(4) claim. In the case of *Ragsdale v. Haller,* 780 F.2d 794 (9th Cir.1986), the Ninth Circuit held that, under California law, the partners in a partnership did owe one another the type of fiduciary duty contemplated by section 523(a)(4). *Id.,* at 796-97. The court found that, while the California partnership statute only created a trust *ex maleficio,* the California state courts had imposed additional duties on the partners in a partnership:

> In California, partners are trustees for each other and in all proceedings connected with the conduct of the partnership every partner is bound to act in the highest good faith to his co-partner and may not obtain any advantage over him in the partnership affairs by the slightest misrepresentation, concealment, threat or adverse pressure of any kind.

Id. at 796. (Quoting *Leff v. Gunter,* 33 Cal.3d 508, 514, 189 Cal.Rptr. 377, 381, 658 P.2d 740, 744 (1983)). The court concluded that the obligations imposed by the California courts were "more than just a fiduciary relationship created in response to some wrongdoing; California has made all partners trustees over the assets of the partnership." *Id.* As a result, the court held that the debtor's debt to his partner was not dischargable.[9] *Id.*

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[9] Subsequently, the Ninth Circuit held that, under Washington law, partners were also fiduciaries for purposes of section 523

The *Hurbace* court declined to follow the *Ragsdale* decision, finding that the Texas courts had not imposed the same type of fiduciary duties on partners as the California courts. *In re Hurbace*, 61 B.R. at 566. The court observed that:

> It is only when viewing the position of managing partners do Texas courts venture to impose the type of fiduciary duty described in *Ragsdale*. (Citations omitted).

Id. The court concluded:

> . . . in the present case dealing not with a managing partner vis-a-vis general partners but with equal co-partners, the scope of fiduciary duty described in *Ragsdale* is not applicable . . . [~~and~~] . . . § 523 (a)(4) insofar as it relates to a debtor acting in a fiduciary capacity does not apply to the failure of partners to account.

Id. Therefore, the court in *Hurbace* held that under Texas law, there was not a sufficient fiduciary duty between equal co-partners of a general partnership to satisfy the requirements of section 523(a)(4).

However, the case at bar does not involve equal co-partners, as the *Hurbace* case did. In this case the Court must decide first whether, under Texas law, the scope of fiduciary duty owed by a general partner to limited partners meets the express trust requirements of section 523 (a)(4), and second, whether such a duty exists for or can be imputed to the managing partner of the managing partner.

(a)(4). *Lewis v. Short* (In re Short), 818 F.2d 693, 695-96 (9th Cir. 1987).

The Appellants argue that the Texas courts have long held that a partner in complete control of a partnership, whether the general partner of a limited partnership or the managing partner of a general partnership, owes one of the highest fiduciary duties known at law to his partners. The Appellee, on the other hand, relying on the opinion of the district court, argues that, while the Texas courts have imposed a very high level of fiduciary duty on managing partners, they have done so only in the context of constructive trusts and, therefore, by definition these obligations are insufficient to meet the express trust requirements of the bankruptcy discharge provisions.[10]

The Texas Supreme Court case of *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex. 1976), is generally cited as the primary authority for the imposition of trustee-like duties on the managing partner of a partnership. The *Huffington* case did involve the imposition of a constructive trust. *Id.* at 577. Likewise, the two cases cited by the court in *Huffington* in support of the proposition that managing partners owe the highest level of fiduciary obligation to their co-partners, were also constructive trust cases. *See Smith v. Bolin*, 153 Tex. 486, 271 S.W.2d 93 (1954); *MacDonald v. Follett*, 142 Tex. 616, 180 S.W.2d 334 (1944).

However, contrary to Bennett's contention, this principle has not been limited to cases involving constructive

[10] In support of its holding, the district court relied in part on the case of *CRL of Maryland, Inc. v. Holmes*, 117 B.R. 848 (Bankr. D.Md. 1990). The court in *Holmes* held that a statutory trust cannot be a technical trust for purposes of section 523(a)(4) in the absence of the execution of a formal trust agreement between the parties because the creation of an express trust depends upon the intention of the parties and can never be created by statute alone. *CRL of Maryland, Inc. v. Holmes*, 117 B.R. at 853. This Circuit has not taken such a technical approach to the interpretation of section 523(a)(4), *see e.g. Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir. 1990), and does not find that such an approach is warranted in this case.

trusts. In *Cook v. Peacock*, 154 S.W.2d 688 (Tex.Civ. App.—Eastland 1941, writ ref'd w.o.m.), a case involving an action for a partnership accounting, the court observed that "[t]he duty of a partner in control of . . . a business is analogous to that of a trustee." *Id.*, at 691. *See also Conrad v. Judson*, 465 S.W.2d 819, 828 (Tex. Civ.App.—Dallas 1971, writ ref'd n.r.e.), *cert. denied*, 405 U.S. 1041, 92 S.Ct. 1312, 31 L.Ed.2d 582 (1972); *Johnson v. Buck*, 540 S.W.2d 393, 412-13 (Tex.Civ.App. —Corpus Christi 1976, writ ref'd n.r.e.); *Cf. Johnson v. J. Hiram Moore Ltd.*, 763 S.W.2d 496, 499 (Tex.App. —Austin 1988, writ denied); *Veale v. Rose*, 657 S.W.2d 834, 837 (Tex.App.—Corpus Christi 1983, writ ref'd n.r.e.).

In *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex.Civ.App.—Austin 1978, writ ref'd n.r.e.), a case brought for breach of fiduciary duty, the court held:

> In a limited partnership the general partner, acting in complete control, stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of the trust. (Citations omitted).

Id., at 182. And in the *Crenshaw* case, discussed at length below, the court stated:

> It is axiomatic that a managing partner in a general partnership owes his co-partners the highest fiduciary duty recognized in the law.

Crenshaw v. Swenson, 611 S.W.2d 886, 890 (Tex.Civ. App.—Austin 1980, writ ref'd n.r.e.).

This Court has previously observed, in deciding whether tax attributes associated with certain commercial real estate should be attributed to a corporation or a partnership, that the duty a general partner owes to limited partners is analogous to that owed by a trustee to trust beneficiaries. *Moncrief v. United States*, 730 F.2d

276, 285 (5th Cir.1984) (Citing *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.)).

Further, in *Moreno v. Ashworth*, 892 F.2d 417, 421 (5th Cir. 1990), we held that the debtor, who was an officer of a corporation, owed a fiduciary duty to that corporation and its stockholders. We found that because the debtor had entered into certain self-dealing transactions while an officer of the corporation, the debts arising from these transactions were not dischargeable under the provisions of 11 U.S.C. § 523(a)(4). *Id.* Because the role of an officer or director of a corporation with respect to the shareholders is analogous to the role of managing partner of a limited partnership with respect to the limited partners, *Moreno*, by analogy, supports the argument that the managing partner of a limited partnership owes a sufficient fiduciary duty to the limited partners to satisfy the requirements of section 523(a)(4).

Significantly, the specific duties imposed by the Texas courts on managing partners pursuant to this line of cases are the same as those imposed on trustees. They include the duty of loyalty, *Huffington*, 532 S.W.2d at 579, and the duty to "deal with one another with the utmost good faith and most scrupulous honesty." *Johnson*, 763 S.W.2d at 499. As the court in *Crenshaw* stated, when a general partner is in complete control of the assets and affairs of a limited partnership:

> [His] conduct must be measured by standards exacting the utmost fidelity. . . . Not only is it [the general partner's] duty to administer the partnership affairs solely for the benefit of the partnership, he is not permitted to place himself in a position where it would be for his own benefit to violate this duty.

Crenshaw, 611 S.W.2d at 890.

We find, as the Ninth Circuit did in *Ragsdale*, that these obligations are more than a fiduciary relationship

created in response to some wrongdoing. Texas law clearly and expressly imposes trust obligations on managing partners of limited partnerships and these obligations are sufficient to meet the narrow requirements of section 523(a)(4).

However, this is only the first step in the analysis, because it is undisputed that Bennett was not the managing partner of MG. He was instead, the managing partner *of the managing partner* of MG. Therefore, this Court must now address the more difficult question of whether Texas law imposes these same trust-type obligations on the managing partner in a two-tiered partnership arrangement, i.e. the managing partner of the managing partner.

In support of their argument that Bennett did owe a trustee's fiduciary obligation to the limited partners of MG, the Appellants rely on the case of *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.). They argue that both the facts and the court's analysis in that case support the proposition that under Texas law a general partner of a general partner of a limited partnership owes a fiduciary duty of loyalty to the limited partners. Because *Crenshaw* is the only case that arguably supports the Appellants' contention it merits further discussion.

The *Crenshaw* case was a suit for breach of fiduciary duty, and involved a limited partnership known as Rolling Hills Majestic Homes (Group I), Ltd. This limited partnership was formed for the purpose of constructing and selling four homes in Austin, Texas. The general partner of this limited partnership was another partnership, known as Occidental Syndicated Investments (Occidental). The original partners in Occidental were Elizabeth Swenson, Robert Johnson and James Cooper. *Id.*, at 888. Elizabeth Swenson, the defendant in the *Crenshaw* case, was therefore a general partner of the general partner of a limited partnership; a relationship clearly analogous to

that of Archie Bennett vis-a-vis the MG limited partnership.

In *Crenshaw*, the limited partnership agreement provided that the limited partners would contribute capital to the partnership, a portion of which was to be used to purchase tracts of land for development. Title to these tracts was held by Swenson Corporation, a corporation wholly owned by Elizabeth Swenson and her husband, Vernor Swenson. After the lots were purchased from Swenson Corporation, the limited partnership attempted to obtain a construction loan to finance the building of houses on the lots. The lender refused to make the loan to the limited partnership, but agreed to lend the money to Swenson Corporation. As a result, the lots were transferred back to the Swenson Corporation so that the property could be used as security for the construction loan. *Id.*

Subsequently, a variety of problems developed with respect to the construction and sale of the houses. The partnership sustained losses, and the limited partners were left empty-handed and disgruntled. The limited partners then brought suit against Elizabeth Swenson for breach of fiduciary duty. *Id.* at 888-889.

The *Crenshaw* court decided the case based on the law of trusts stating:

> It is axiomatic that a managing partner in a general partnership, owes his co-partners the highest fiduciary duty recognized in the law. In a limited partnership, the general partner acting in complete control stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of the trust. We must then, in deciding this case, do so under the laws applicable to trusts.

Crenshaw, 611 S.W.2d at 890. The court phrased the legal issue as whehter "the trial court erred in failing to find that appellee, Elizabeth Swenson, breached her fidu-

ciary duty of loyalty to the partnership and to the limited partners." *Id.*

The court reviewed the particular facts of the case and observed that, "a conveyance of partnership property was made and the proceeds from the sale . . . were deposited in the Swenson Corporation . . . without the knowledge or consent of [the limited partners]". *Id.*, at 891. The court also noted that, "the Swenson Corporation was the general contractor in absolute control of the partnership's destiny and . . . Elizabeth Swenson had the right to the exclusive listing when the finished product was sold . . ." *Id.* Taking these facts together, the court concluded that "the case takes on an aura of self-dealing which this Court is unable to condone." *Id.* The court then held that Ms. Swenson had breached her fiduciary duty of loyalty to the limited partners as a matter of law, and that these limited partners were entitled to equitable restitution of their investment in the limited partnership. *Id.*

The Appellants assert that because Elizabeth Swenson was a general partner of the general partner of the limited partnership, and because the appellate court held that she owed the limited partners the fiduciary obligations of a trustee, the case stands for the proposition that under Texas law a general partner of a general partner owes fiduciary responsibilities directly to the underlying limited partners.

Bennett disagrees with the Appellants' interpretation of *Crenshaw*. He argues that *Crenshaw* is distinguishable because,

> [W]hen all of the other general partners of Occidental Syndicated Investments resigned from the partnership, that action effected a dissolution of the separate partnership entity leaving only Swenson to act in an individual capacity as the general partner of the limited partnership.

Brief of Appellee Archie Bennett, Jr., at pp. 18-19.

While the court in *Crenshaw* does note that "[s]ubsequent to the execution of the partnership agreement, both Robert Johnson and James Cooper resigned as general partners," it does not indicate *when* this occurred. *Crenshaw*, 611 S.W.2d at 888. Nor does the court suggest anywhere in its opinion that this fact was relevant to the conclusions it reached. In fact, in describing the critical transfer of property that forms the basis for the conclusion that Elizabeth Swenson breached her fiduciary duty to the limited partners, the court states that "the general *partners* transferred title to the lots back to the Swenson Corporation. . . ." *Id.* This indicates that, at least at the time the alleged breach occurred, Ms. Swenson was not acting individually as the general partner of the limited partnership. To the contrary, the statement that the "general partners transferred title . . ." indicates that the transfer was effected by Occidental, as the general partner of the limited partnership. Therefore, Bennett's attempt to distinguish *Crenshaw* is not persuasive.

The difficulty this Court has with the Appellants' interpretation of the *Crenshaw* case is that the court in that case never acknowledged or even alluded to the fact that it was expanding the fiduciary duty rules applicable to managing partners to encompass the managing partners of *managing partners*. The *Crenshaw* court simply applied these fiduciary duty rules to Ms. Swenson who, in fact, was a general partner of a general partner of a limited partnership.

In concluding that Ms. Swenson owed fiduciary obligations to the limited partners, the *Crenshaw* court focused on the nature of the business relationship as a whole, in which one person, Elizabeth Swenson, in her various roles as general partner of the general partner, owner of the corporation hired to accomplish the construction project, and the real estate broker authoirzed to sell the properties when completed, exercised almost total control over the project. This high level of control, over the project and

the limited partners' investments, appears to have been critical in persuading the *Crenshaw* court that Ms. Swenson owed a fiduciary duty to the limited partners.

In reviewing the line of cases that gave rise to the rule in Texas that the managing partner of a partnership owes to his copartners the highest fiduciary obligations known at law, it is clear that the issue of control has always been the critical fact looked to by the courts in imposing this high level of responsibility.

In *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex. 1976), the case generally cited as establishing the common law rule in Texas that the managing partner of a partnership owes to his copartners one of the highest fiduciary duties recognized at law, the Texas Supreme Court cited three cases: *Smith v. Bolin*, 153 Tex. 486, 271 S.W.2d 93 (1954), *MacDonald v. Follett*, 142 Tex. 616, 180 S.W.2d 334 (Tex.1944), and *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928).

Smith v. Bolin involved a partnership in which the respondent, Bolin, was the "business manager". *Smith v. Bolin*, 271 S.W.2d at 94. Bolin, individually, had entered into renewal leases of certain oil and gas properties that had previously been leased by the partnership. He was sued by his partners for breach of fiduciary duty. The parties disagreed about whether the partnership was still in existence at the time Bolin entered into the disputed transactions, but the court, in reversing the summary judgment granted to Bolin by the trial court, quoted extensively from the opinion in *Meinhard v. Salmon*, and held that "[a]s managing partner of their partnership enterprise, respondent owed his partners even a greater duty of loyalty than is normally required." *Id.* at 96. The critical fact underlying this "greater duty of loyalty than is normally required," was the greater degree of control that one partner (i.e., the managing or business partner) had over the operation of the partnership and hence the investment of the other partners.

Likewise, in a case cited extensively in Texas and elsewhere for establishing the fundamental fiduciary duty rules governing managing partners, Justice Cardozo focused on the control that one "coadventurer" exercised over the business enterprise at issue:

> The very fact that Salmon was in control with exclusive powers of direction charged him the more obviously with the duty of disclosure . . .

Meinhard v. Salmon, 164 N.E. 545, 547 (N.Y. Court of Appeals 1928). The court observed:

> [T]here may be no abuse of special opportunities growing out of a special trust as manager or agent. . . . Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation. He was much more than a coadventurer. He was a managing coadventurer. For him and for those like him the rule of undivided loyalty is relentless and supreme. (Citations omitted).

Id. at 548. Therefore, again in the *Meinhard* case the fact of control or management is vital to the court's analysis.

Since the critical fact focused on by the courts in these cases was the control exercised by one person (partner or coadventurer or cotenant) over the enterprise at issue, the court's analysis in *Crenshaw*, focusing also on the issue of control, is consistent with the manner in which Texas jurisprudence has developed in this area.

However, as set forth above, the determination of whether section 523(a)(4) precludes the discharge in this case of Bennett's debts to the limited partners involves interpretation of both federal and state law. The law in this Circuit is clear that exceptions to discharge are narrowly construed against creditors and in favor of the bankrupt. *Coburn Company of Beaumont v. Nicholas*, 956 F.2d 110, 113 (5th Cir.1992) (citing *Boyle v. Abilene Lumber, Inc.*, 819 F.2d 583, 588 (5th Cir.

1987)). And this Court has previously indicated that section 523(a)(4) should be applied to deny a discharge only in cases where either the common law or a statute clearly and expressly imposes trustee-like obligations on the debtor. *See e.g., Carey Lumber Company v. Bell*, 615 F.2d 370, 374 (5th Cir. 1980) ("The [Oklahoma lien trust] statutes expressly and clearly impose a trust relationship upon construction mortgagors.") The fatal flaw in the *Crenshaw* analysis is that the court did not expressly and clearly find that the common law fiduciary duty of managing partners applied to managing partners of managing partners. The holding in *Crenshaw* is therefore too ambiguous for this Court to apply it to deny Bennett a discharge under section 523(a)(4) in this case.[11]

The Court finds that Texas law does not clearly and expressly impose a trust relationship between the managing partner of the managing partner of a limited partnership and the limited partners. Therefore, the judgment of the district court and the bankruptcy court are hereby AFFIRMED.

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[11] The Court located only one other case in which an issue similar to the one at bar was decided. In *Park v. Moorad*, 132 B.R. 58 (Bankr.Okla. 1991), the debtor was the president, director and sole shareholder of a corporation, which in turn was the general partner of a limited partnership. *Id.* at 60. At issue in *Park* was whether the debtor as an individual should be granted a discharge of debts owed by the corporation to the limited partners. The bankruptcy court was not persuaded by the argument that only the corporation as the managing partner owed a fiduciary duty to the limited partners and denied the discharge, under section 523(a)(4), stating that the debtor would not be allowed to "hide beneath a corporate shell when he so completely controlled the corporate actions, representations and decisions that in effect it had no life without him." *Id.* at 63.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF: ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, *et al.*,
Appellants,

versus

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court for the Northern District of Texas

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[Filed Sept. 1, 1993]

Before POLITZ, Chief Judge, HIGGINBOTHAM, Circuit Judge and PRADO, District Judge.*

BY THE COURT:

IT IS ORDERED that appellants' motion to clarify the Court's judgment is DENIED.

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* District Judge of the Western District of Texas, sitting by designation.

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Appellee.

Appeal from the United States District Court for the Northern District of Texas

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[Filed July 19, 1993]

ORDER:

(✓) The motion of appellee for (X) say ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is DENIED.

( ) The motion of appellee for (X) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including ————————, the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within the period above mentioned there shall be filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court that the certiorari petition has been

filed. The Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of the stay granted herein, unless the above mentioned certificate shall be filed with the Clerk of this Court within that time.

/s/ Henry A. Politz
Chief Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Bankruptcy Case No. 388-37142-RCM-7

IN RE: ARCHIE BENNETT, JR.,
Debtor.

Civil Action No. CA 3-90-0766-G

LSP INVESTMENT PARTNERSHIP, a Texas Partnership, *et. al.*,
Appellants,

vs.

ARCHIE BENNETT, JR.,
Appellee.

MEMORANDUM ORDER

[Filed December 14, 1990]

This case is before the court on the appeal of LSP Investment Partnership *et al.* ("LSP") from the judgment of the bankruptcy court entered on February 20, 1990. For the reasons stated below, the decision of the bankruptcy court is affirmed.

I. *Background*

LSP consists of some of the limited partners of Mariner/Greenspoint, Ltd. ("Mariner/Greenspoint"), a Texas limited partnership. The sole general partner of Mariner Greenspoint was another limited partnership named Mariner Interest No. 20, Ltd. The sole general partner of

Mariner Interest No. 20 was the appellee, Archie Bennett, Jr. ("Bennett"). Mariner Greenspoint was organized to construct and operate a Marriott hotel near Greenspoint Mall in Houston, Texas. After construction of the hotel, defective ventilation caused the formation of mildew in many of the guest rooms, requiring substantial repairs. LSP disputed Bennett's withdrawal of $1,000,000 from partnership funds as his compensation, as well as Bennett's use of partnership funds for the payment of mildew repairs and certain lease obligations.

On November 23, 1988, Bennett filed for bankruptcy under Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq.* LSP then filed an adversary proceeding in the bankruptcy court to determine the dischargeability of Bennett's debt. The bankruptcy court held that the debts in controversy were dischargeable, and that if its order were reversed on appeal, then LSP would only be entitled to $832,204 for defalcations related to certain leases and mildew repair.

II. *Analysis*

A. *Standard of Review*

The court will review *de novo* the legal conclusions of the bankruptcy court. The bankruptcy court's findings of fact, however, will not be overturned on appeal unless they are clearly erroneous. Matter of Consolidated Bancshares, Inc., 785 F.2d 1249, 1252 (5th Cir. 1986). A finding of fact is clearly erroneous "when although there is evidence to support it, the reviewing court on the entire evidence is left with the firm and definite conviction that a mistake has been committed." Anderson v. City of Bessemer City, North Carolina, 470 U.S. 564, 573 (1985) (quoting United States v. United States Gypsum Company, 333 U.S. 364, 395 (1948)).

B. *Dischargeability*

The Bankruptcy Code provides in § 523(a)(4) that an individual may not be discharged from debts incurred

"for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523 (a)(4). LSP contends that because Bennett was the general partner of the limited partnership that in turn was the general partner of Mariner Greenspoint, Bennett owed LSP a fiduciary duty.

Neither side disputes the principle of law that a general partner owes a fiduciary duty to his limited partners. Rather, the point of contention here is the breadth of the term "fiduciary capacity," as it is used in § 523(a)(4). LSP argues that the term refers to all fiduciaries recognized by the law, while Bennett argues that the term encompasses only trustees of an express or technical trust. The bankruptcy court applied the narrower definition.

The decisions on this issue are not uniform, and the Fifth Circuit has provided no direct guidance. In Davis v. Aetna Acceptance Company, 293 U.S. 328 (1934), the Supreme Court interpreted the provision in the Bankruptcy Act of 1898 disallowing discharge of debts arising from defalcation by fiduciaries to apply only to technical trusts, not trusts implied by the law:

> The respondent contends that, irrespective of willfulness or malice, the petitioner is within the exception declared by subdivision 4 [denying discharge from liabilities "created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity"]; his liability arising, it is said from his fraud or misappropriation while acting in a fiduciary capacity. The meaning of these words has been fixed by judicial construction for very nearly a century. Chapman v. Forsyth, 2 How. 202, 11 L. Ed. 236, decided in 1844, is a decision to the effect that, within the meaning of a like provision in the Act of 1841 (5 Stat. 440), a factor does not act in a fiduciary capacity; the statute "speaks of technical trusts, and not those which the law implies from the contract." 2 How. at page 208, 11 L. Ed.

> 236. The scope of the exception was to be limited accordingly.

Id. at 333.

The Fifth Circuit has also interpreted the Bankruptcy Act to limit the defalcation exception to discharge to trustees of express or technical trusts. Matter of Angelle, 610 F.2d 1335, 1339 (5th Cir. 1980). The court in *Angelle* recognized such a limitation as consistent with the "well-established principle" that exceptions to discharge should be limited to those clearly expressed in the statute. *Id.* at 1339; *see also* Gleason *v. Thaw,* 236 U.S. 558, 562 (1915).

While the Supreme Court and the Fifth Circuit have yet to decide whether this reasoning applies to the Bankruptcy Code of 1978, the bankruptcy court in the Western District of Texas has done so. In re Hurbace, 61 B.R. 563, 565 (Bankr. W.D. Tex. 1986). There, the court applied § 523 to determine the dischargeability of one partner's debt to another. After referring to *Davis* to support its conclusion that the language of § 523 (a)(4) encompasses only trustees of express or technical trusts, the court examined the Texas Uniform Partnership Act, TEX. REV. CIV. STAT. ANN. art. 6132b § 21 (Vernon 1970), to decide whether it established an express or technical trust. Section 21 provides:

> (1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

This provision, as the *Hurbace* court noted, establishes a constructive trust against the partner who improperly uses the profits of the partnership.

Though Bennett was the managing partner of the limited partnership, and Texas courts have imposed a higher degree of fiduciary duty on managing partners, they have done so in the context of constructive, rather than technical, trusts. *See* Huffington v. Upchurch, 532 S.W.2d 576, 577, 579 (Tex. 1976); *Crenshaw v. Swenson*, 611 S.W.2d 886, 890 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.). Under Texas law, an express trust requires that the party claiming the trust must prove that the settlor intended to create a trust, that the subject to which the trust obligation relates is certain, and that the beneficiary is certain. *Hurbace*, 61 B.R. at 566 n.2.

The purpose of the Bankruptcy Code is to give debtors a fresh start, and the discharge of indebtedness is the primary vehicle of this fresh start. If this court were to adopt too broad a definition of fiduciary for the purposes of § 523 (a)(4), it would be defeating the Code's purpose.[1]

Accordingly, because Bennett is not a trustee of an express or technical trust under Texas law, the court concludes that the debts in question are dischargeable notwithstanding § 523(a)(4).[2]

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[1] This court is persuaded by the observation in In re Hutton, 117 B.R. 1009 (Bankr. N.D. Okl. 1990), that one consequence of an overbroad interpretation would be that

> debtors who owe fiduciary duties under state law would be denied a discharge of their debts even though they were completely honest but had in some way breached a fiduciary duty through inadvertence, negligence, or a lack of knowledge of the law.

Id. at 1013.

[2] Other recent decisions have allowed discharges on similar grounds. In re Holmes, 117 B.R. 848, 852 (Bankr. D. Md. 1990); In re Stone, 91 B.R. 589, 594 (D. Utah 1988). *But see* In re Schiraldi, 116 B.R. 359, 361-62 (Bankr. D. Conn. 1990) (extending the meaning of fiduciary in § 523(a)(4) to include the fiduciary duty of a corporate officer); In re Snyder, 101 B.R. 822, 831-35 (Bankr. D. Mass. 1989).

C. *Judgment*

In light of the court's conclusion that Bennett's debt was properly discharged, it need not discuss the bankruptcy court's alternative conclusion as to the proper judgment upon reversal.

III. *Conclusion*

The exception to dischargeability for defalcation or fraud by a fiduciary in 11 U.S.C. § 523(a)(4) applies only to fiduciaries who are trustees of express or technical trusts. The judgment of the bankruptcy court is AFFIRMED.

SO ORDERED.

/s/ A. Joe Fish
A. JOE FISH
United States District Judge

December 14, 1990.

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Case No. 388-37142 RCM-7

IN RE: ARCHIE BENNETT, JR.,
Debtor.

Adversary No. 389-3110

LSP INVESTMENT PARTNERSHIP, a Texas Partnership, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (by its agent, Fred E. Croshaw), W. ROBERT BROWN, OBIE & CO. (by its agent, Frank A. Liddell, Jr.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE
Plaintiffs,

VS.

ARCHIE BENNETT, JR.,
Defendant.

MEMORANDUM OPINION

[Entered February 23, 1990]

Factual Background

This complaint under § 523(a)(4) was tried December 18, 1989 through December 20, 1989. The only offense pled by the Plaintiffs was a § 523(a)(4) violation. Fol-

lowing are the Court's Findings of Fact and Conclusions of Law under Bankruptcy Rule 7052 in connection with such trial.

Findings of Fact

Plaintiffs are and were, at all relevant times in question, limited partners in a partnership known as Mariner/Greenspoint, Ltd. ("MG"). When the partnership agreement was executed for MG, such partnership was a legal entity, distinct from Archie Bennett, Jr. ("Bennett" or "Defendant"). Bennett individually executed such partnership agreement on a limited basis, and, only with respect to Paragraph 10 of the agreement. He signed it also on behalf of Mariner Interest No. 20, Ltd. ("No. 20"), of which he was the sole general partner.

No. 20 is and was, at all relevant times, the general partner of MG.

Bennett is and was, at all relevant times, the general partner of No. 20.

Bennett is a debtor in the bankruptcy case 388-37142 RCM-7, filed on November 23, 1988.

The background facts with Bennett and the Plaintiffs is best understood by the following diagram:

MG (plaintiffs are limited partners)

No. 20 (the general partner)

Bennett (the general partner and debtor/defendant)

The partnership constructed and owned a Marriott Hotel located near Greenspoint Mall at 255 Northbelt East, Houston, Harris County, Texas.

The partnership agreement is attached to the complaint as Exhibit "A".

Plaintiffs invested the sums described in Exhibit "B" to the complaint.

Under the terms of the agreement, the general partner was charged with management of the partnership and had full, exclusive, and complete authority and discretion to manage, control and make all decisions affecting the purposes of the partnership, to take any action required to effectuate the purpose set forth in Article 1.6 of the agreement, and to exercise all rights and powers generally conferred on inferred by law with regard to such obligations.

The general partner was required to act in good faith in the performance of the obligations of the agreement.

The general partner was obligated under Article 2.1 (a)(6) of the partnership agreement of MG to contribute cash to the extent necessary to pay all of the actual costs, to the extent the aggregate costs exceeded $22 million, incurred to construct, equip and furnish the Greenspoint Marriott ("GM") in such a manner that it could be opened and operated as a first-class hotel. *Under Article 7.1 of the partnership agreement, the general partner was not to take the construction "savings" until the project construction costs were paid.*

Reading Article 7.1 and 2.1(a)(6) in conjunction with one another, the general partner was to use the first $22 million in funds borrowed and advanced to the extent necessary to pay all of the actual costs incurred to construct equip and furnish the hotel in such a manner that it could be opened as a first-class hotel.

"First-class" hotel is not a defined term, but, in the context of this case, meant a Marriott-type hotel.

In approximately the third week of November, 1980, when the GM was approximately 90%-95% completed, Bennett was made aware of mildew problems surfacing then in some of the guest rooms at the Brookhollow Marriott ("BM") in Houston, which mildew problems were similar to those which eventually plagued the GM. The

BM had opened in January 1980. The BM and GM were designed the same. The GM had been designed in 1979.

The heating, ventilation, and air conditioning design of the BM was substantially the same as the GM.

Mariner Corporation ("MC") and Bennett attempted to rectify the mildew problem by, among other things, rebuilding those rooms which were damaged by mildew, including the removal of all wall coverings, sheetrock, and fiberglass insulation, and the reinstallation of such materials.

Before taking any distribution for "savings" (Paragraphs 7.1 and 2.1(a)(6) of the MG partnership agreement (PX 2)), the general partner was to provide all equipment to operate the hotel as a first-class hotel.

MC, at all times relevant to this action, was owned 100% by Bennett. MC, and its officers and employees acted on behalf of No. 20 and Bennett in carrying out the obligations of the general partner of MG. Bennett retained MC and its employees to perform his duties as general partner of No. 20, and, in turn, its duties as general partner of MG. MC and its officers and employees acted on Bennett's behalf in performing such obligations.

The GM opened in January 1981.

Prior to the opening, MC was concerned about its loan arrangement, which was committed only until February 1981. If MC was unable to complete the construction and missed the opening, MC stood to possibly lose substantial sums.

Eaves Construction Co. ("Eaves"), the general contractor ultimately awarded the construction contract for the GM was one of the original bidders for the GM. All of the bids initially submitted to MC, including Eaves', were at least $1 million over the budget amount of $22 million.

Subsequently, after consultation with MC, Eaves dropped its bid price by $1 million and got the bid. However, Eaves was unable to obtain a bond. Bennett told Eaves it could have the job without a bond if it reduced its fee (the general contractor's fee) by one-half.

The general contractor's fee represents its profit on the job, assuming there are no construction savings. According to credible testimony, sometimes owners are more interested in the ability of the general contractor to obtain a bond, *i.e.*, "bondability", rather than the general contractor actually obtaining a bond. Bennett required various of the major subcontractors to put up bonds on the Greenspoint project.

Eaves was unable to obtain a bond due to its lack of financial strength and lack of a sufficient track record on large projects.

The reduction of the contractor's fee reduced the Eaves bid by $250,000.

It is not normal on large projects, such as the project in question, to use a general contractor who does not have the ability to get bonded.

Bennett had had good experience with Eaves' capabilities in connection with a large renovation project on the Galvez Hotel in Galveston; however, some MC personnel expressed concern to Bennett about Eaves' ability to run a business. Eaves finished the project in question, but, thereafter, became insolvent.

MC employees were aware that, if the project was completed under budget, the savings would be paid directly to Bennett.

The hotel was built on a "fast track" system. This system involved developing plans to a certain point, and having subcontractors bid on the specifications without the benefit of actual drawings. This type of system accelerates completion of the project. Marriott had to ap-

prove all plans developed under the "fast track" system. In the construction industry, there is apparently nothing particularly unusual about a "fast track" system, *i.e.*, it is apparently common in the industry.

In August 1980, Marriott reluctantly granted approval of the heating, ventilation and air conditioning design for the GM because of the advanced stage of the construction. However, Marriott anticipated that the guest rooms would have a mustry odor. Further, Marriott conditioned its approval upon MC accepting full responsibility for any reparations required by subsequent mildew damage. The design was not acceptable by Marriott design standards and would not be permitted in future hotel projects (see PX 4). On March 4, 1981, Marriott, as management company, issued its certificate to the lender on the hotel that the improvements constituting the GM had been completed in accordance with the plans and specifications approved by Marriott, as management company (see DX 72, tab 12).

At the time of the opening of the GM in January 1981, Bennett received a $1 million distribution. The $1 million was a result of supposedly constructing the GM for less than the budgeted $22 million.

Mildew began to occur in the guest rooms of the GM in April 1981. By July 1981, mildew had appeared in 169 of the 400 rooms at the GM. In April 1981, Marriott had determined that the "negative pressure" of the hotel contributed to the mildew problem.

"Negative pressure" in a building occurs when more air is exhausted from the building than is made up with conditioned air. The result is that warm, humid air will be drawn into the building to equalize the pressure.

By June 1981, MC continued to identify the "negative pressure" in the GM as contributing to the mildew problem. Marriott requested that Mariner correct the problem.

By August 1981, 398 of the 400 rooms at the GM had been damaged by mildew. MC was aware that the building exhausted more air than was made up by the conditioned air. MC requested that Eaves revinyl and resheetrock all of the rooms and correct the mildew problem at its own expense. Eaves did revinyl and resheetrock, but the mildew problem was not cured.

MC and Bennett were informed in June 1981 that the "negative pressure" problem could allegedly be resolved at a cost of between $125,000 and $175,000. At such time, legitimate business questions existed as to the complete cause of the mildew problem—who was responsible for it, and what was the most reasonable and economical method of attempting to cure same. Disagreements existed among MC personnel as to whether a bandaid approach or a major surgery approach was necessary to cure the problem.

In the summer of 1982, after all of the rooms at the GM had been revinyled and resheetrocked, mildew again appeared in numerous guest rooms. It was noted by the manager of the hotel, in correspondence at that time, that it was obvious that they would be revinyling rooms until everyone was "old and gray" unless the "negative pressure" problem was rectified.

In 1982, the rooms of the GM were thereafter again revinyled and resheetrocked. Additional modifications were also made to resolve the vapor barrier problems which had been found to exist. The interior faces of the wall vinyl in the guest rooms acted as vapor barriers. When a wall was cooled by air conditioning, the cooling effect caused moisture inside the wall to condense and saturate the sheetrock, thus permitting mildew to form and bleed through the vinyl wall coverings. The revinyling, resheetrocking and other modifications made in 1982 were charged to the partnership earnings and paid for by the partnership. That is, the costs were charged, in part, to the limited partners. The total sum paid by the part-

nership for the second round of reconstruction totaled $192,915. The limited partners' share of this $192,915 cost was approximately $72,000. This was the only time the partnership paid any direct costs in connection with the mildew problem at the GM.

In 1983, the mildew again reappeared in the rooms at the GM. However, the hotel also suffered damage as a result of Hurricane Alicia and insurance proceeds were used to replace the vinyl and sheetrock a third time. Following such repairs, there have been no further substantial or major mildew problems at the GM. There has been substantial developments and research into the general cause of mildew since 1982. There was insufficient evidence of any net revenue loss to the GM as a result of the mildew problem.

The testimony of expert John Keeling was credible. He was a stipulated expert on hotel consultation and was intimately familiar with the Houston hotel market. He testified that generally GM outperformed its competitors in the Houston market during all pertinent times herein, and that no alleged "design defect" showed up in such hotel's market share. He further testified that most of the hotels in Houston that were new at the time the GM was new have gone back to their lenders by virtue of the depressed Houston market.

It was the responsibility of the general partner to build, construct and equip the hotel. Plaintiffs further contend that, as a result, it was the responsibility of the general partner, No. 20, and, in turn, Bennett individually, to pay for all corrective construction and resolve the mildew problem. As previously found, the limited partners' share of this expense was approximately $72,000.

Monetary Responsibility for the Mildew Problem

The first issue appears to be whether the general partner should have established a reserve, before Bennett took

his $1 million "savings", for possible future mildew problems. Under the evidence, it appears that the general partner was under sufficient notice to be required to establish a reserve or to eventually return "savings" money to the extent of the money spent by the partnership on the mildew problem.

The next issue is, once it became clear that the continuous mildew problem was not cured and that the costs of $192,915, of which $72,000 was allocable to the limited partners, were going to be incurred, whether the general partner had an obligation to pay such costs, or whether such costs were properly charged against the partnership as an expense item. Additionally, if such costs were the general partner's responsibility, then was it a § 523(a)(4) breach of fiduciary duty or defalcation by Bennett for No. 20, and, in turn, Bennett, as general partner thereof, to have taken such costs out of partnership funds.

Contract Provisions

Article 5 of the MG partnership contract (PX 2, pp. 23 and 24) reads as follows:

EXPENSES AND OTHER
CHARGES TO THE PARTNERSHIP

5.1 *Permitted Expenses and Charges.* The General Partner may charge to the Partnership and pay or recover out of the Partnership funds, as and when available, the following: all reasonable expenses incurred by the General Partner to preserve, protect, or perfect the title to the Partnership Property or to maintain such Property, including, but not limited to, travel expenses, attorney's fees and court costs incurred in connection with such matters; the cost of all insurance carried in connection with the business of the Partnership; taxes on Partnership Property and services rendered to the Partnership; principal and/or interest owing on any indebtedness of

the Partnership, together with any expense incurred in connection with renewing or rearranging such indebtedness; and any other expensess [sic] due to third parties reasonably incurred for the operation of the Partnership's business or for the furtherance of the Partnership purposes.

Provided, further, that if the General Partner or any individuals, companies, or other entities with which the General Partner is affiliated shall perform or provide services for the Partnership which are reasonably necessary to accomplish the purposes of the Partnership, including, but not limited to, accounting, bookkeeping, engineering, construction supervision, decorating, landscaping, management, brokerage, architectural design and the like, the General Partner or its affiliates shall be entitled to be paid for services in amounts not in excess of amounts which could be reasonably negotiated at arms' length with qualified nonaffiliated third parties for the performance of such services, provided, however, that the General Partner shall disclose all such payments, in the reports referred to in Section 3.2 above.

5.2 *Expenses and Charges Not Chargeable to the Partnership.* No expense or charges shall be paid or recovered out of Partnership funds except those provided for in Section 5.1 hereof.

When Article 5 is taken in connection with Article 2.1(a)(6) and PX 4, it appears that the general partner agreed to spend the initial $22 million to deliver to the limited partnership a hotel that could be "opened and operated as a first-class hotel" (Article 2.1(a)(6). The mildew problem was a continuous construction problem that, insofar as the limited partnership, MG, was concerned, the general partner had an obligation to make sure was fixed and paid for by the general partner if the general partner was not otherwise able to get it fixed by others (at their expense), in order that the hotel would

be "opened and operated as a first-class hotel". Thus, there is a $72,000 obligation owing by No. 20 (of which Debtor was the general partner), for it defalcation when acting in a fiduciary capacity when it spent such $72,000 of the limited partners' funds for such mildew repair.

Was Bennett a Fiduciary of Plaintiffs Within the Meaning of § 523(a)(4)

Seciton 523(a)(4) provides:

> (a) A discharge under section 727, 1141, 1228 (a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> * * * *
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

Courts narrowly construe exceptions to discharge against the creditor and in favor of the debtor. *Matter of Cross*, 666 F.2d 873 (5th Cir. 1982); *Matter of Boyle*, 819 F.2d 583, 588 (5th Cir. 1987).

The question of who is a fiduciary under § 523(a)(4) is a question of federal law, although state law is important in determining when a trust relationship exists. *Matter of Angelle*, 610 F.2d 1335 (5th Cir. 1980); *In re Hurbace*, 61 B.R. 563 (Bankr. W.D. Tex. 1986); *In re Pedrazzini*, 644 F.2d 756 (9th Cir. 1981); *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir. 1986) ("Ragsdale").

The term "fiduciary" applies only to express or technical trusts and does not extend to implied trusts, or constructive trusts which are imposed on transactions by operation of law as a matter of equity. *Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934); *Matter of Boyle, supra*, at 588; *In re Angelle, supra*, at 1338; *In re Hurbace, supra*, at 565; *In re Pedrazzini, supra*, at 758.

Under § 523(a)(4), a plaintiff has the burden of proof to establish two elements: (1) that the debtor was a fidu-

ciary of the creditor and (2) that, while a fiduciary, debtor committed a defalcation. *In re Novak,* 97 B.R. 47 (Bankr. D. Kan. 1987). This requirement that the fiduciary duty of the debtor must actually extend to the creditor is also seen in *Matter of Cross*, where the Fifth Circuit holds that "[§ 523(a)(4)] does so require the claimant to be the beneficiary of a preexisting fiduciary relationship". *Supra*, at 879.

The Ninth Circuit has held that a breach of fiduciary duty between partners is nondischargeable. *Ragsdale, supra.* Based on the California statute imposing a fiduciary duty, identical to § 21 of Texas Partnership Act, the Ninth Circuit concluded that California courts had raised the duties of partners beyond those required by the literal wording of the Uniform Partnership Act.

However, Texas courts have not, to date, extended the partnership relationship generally beyond the frame of reference used in § 21 of the Uniform Partnership Act. *In re Hurbace, supra*, at 566.

An exception appears to exist, however, for the duties imposed under Texas law on the managing partner of a partnership. As a managing partner, one stands in a higher fiduciary relationship with the other partners than partners usually occupy. *Conrad v. Judson*, 465 S.W.2d 819 (Tex.Civ.App.—Dallas 1971, writ ref'd n.r.e.), cert. denied, 405 U.S. 1041 (1972) ("Conrad"); *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex. 1976) (managing partner of partnership enterprise owed copartners one of the highest fiduciary duties recognized in law); *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex.Civ.App.—Austin 1980, writ ref'd n.r.e.) ("*Crenshaw*") (managing partner in general partnership owes copartners highest fiduciary duty recognized in law).

The fiduciary duty imposed under Texas law for a managing partner is analogous to the type of fiduciary

duty described in *Ragsdale, supra,* a duty of a trustee. *In re Hurbace, supra,* at 566; *Conrad, supra,* at 828.

In a non-§ 523(a)(4) case, the Fifth Circuit, in *Palmer v. Fuqua,* 641 F.2d 1146, 1155 (5th Cir. 1981), stated:

> Partners, as a matter of law, stand in a fiduciary relationship to one another. *Thigpen v. Locke,* 363 S.W.2d 247, 253 (Tex. 1962). As sole general partner of Atlanta Limited No. 2, having exclusive power and authority to control and manage the partnership, J. B. Fuqua owed the limited partners as even greater duty than is normally imposed. *Huffington v. Upchurch,* 532 S.W.2d 576, 579 (Tex. 1976).

In *In re Guy,* 101 B.R. 961, 984 (Bankr. N.D. Ind. 1988), the court stated:

> Thus, the Debtor's liability as a fiduciary under § 523(a)(4) will be determined by an analysis of the Sussex Vampire Fund Agreement of Limited Partnership and the rights and duties of the parties arising out of the contractual statutory and common law relationships established between the Debtor, as a general partner and the Plaintiffs as limited partners.

Plaintiffs are limited partners of No. 20, which is a fiduciary to them. Bennett claims that Plaintiffs would have to pierce the entity of No. 20, or prove No. 20 was Bennett's alter ego, in order for Bennett to be liable as a § 523(a)(4) fiduciary of Plaintiffs.

Grierson v. Parker Energy Partners, 737 S.W.2d 375 (Tex.App.—Houston 1987, no writ) ("*Grierson*") was a case involving a corporate general partner of a limited partnership where the president was sued also individually and judgment taken against both the corporation and its president for $346,308.34 actual damages; $500,000 exemplary damages; and $45,000 attorney fees. In the course of its opinion the court stated:

[2-4] Both the pleadings and the evidence fail to show that Grierson was personally liable for $346,308.34 of actual and $500,000 of exemplary damages. The petition does not grant Grierson fair notice. In order to understand this proposition, an analysis of when a corporate officer may be held personally liable without piercing the corporate veil must be undertaken. The Corporation as a general partner owes a fiduciary duty to the limited partners to act in accordance with the partnership agreement and not to misapply funds. *See* Tex.Civ.Stat.Ann. art. 6132a. § 10 (Vernon 1970); Tex.Civ.Stat.Ann. art. 6132b § 21 (Vernon 1970). Corporate officers owe a fiduciary duty to the shareholders and the corporation. *International Bankers Life Insurance Co. v. Holloway,* 368 S.W.2d 567 (Tex.1963); *Canion v. Texas Cycle Supply, Inc.*, 537 S.W.2d 510 (Tex. Civ.App.—Austin 1976, writ ref'd n.r.e.). Generally, however, they owe no duty to third persons. *See Castleberry v. Branscum*, 721 S.W.2d 270, 271-72 (Tex.1986); *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336, 340 (Tex.1968). They may not, however, direct or participate in tortious acts. A corporate agent who knowingly participates in tortious or fraudulent acts may be held individually liable to third persons even though he performed the act as an agent for the corporation. *Barclay v. Johnson*, 686 S.W.2d 334 (Tex.App.—Houston [1st Dist.] 1985, no writ); *3A W. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations* § 1135-52 (1986). This is in contrast to participating in a breach of a corporation contract. Participation in breach of contract will not incur personal liability to the corporate officer. *Barclay*, 686 S.W.2d at 336-37. If the officer knowingly participates in the tortious act, the corporate veil need not be pierced in order to impose personal liability. *Id.* Under Texas law, the breach of a fiduciary duty

is a tort. *Douglas v. Aztec Petroleum Corp*, 695 S.W.2d 312, 318 (Tex.App.—Tyler 1985, no writ). If Grierson knowingly participated in the Corporation's breaching its fiduciary duty to the Partnership, he may be held personally liable.

[5] By merely saying that Grierson breached his fiduciary duties does not imply that he is personally liable for the misapplication of Partnership property. The petition alleges that 'the actions' of Grierson 'as hereinabove set forth constitute a breach of [his] fiduciary duties to the [Partnership].' The actions set forth 'hereinabove', in the petition only complain of Grierson failing to cause the Corporation to resign as general partner and of not transferring the books and records. The petition does not make any allegations of misappropriation or conversion of partnership property as a breach of fiduciary duties. Furthermore, the phrase 'breached his fiduciary duties' is ambiguous and conclusory. In order to hold Grierson personally liable without piercing the corporate veil, he must have knowingly participated in a tortious act. Stating Grierson breached fiduciary duties to the partnership is unclear when he ordinarily owes no fiduciary duty to the Partnership. The Corporation as general partner owes the fiduciary duty. Grierson owes the duty to not direct or participate in the breach of that fiduciary duty. . . .

Also see, In re Long, 774 F.2d 875 (8th Cir. 1985). For a discussion of willful and malicious under § 523 (a)(6), see *In re Dean*, 79 B.R. 659 (Bankr. N.D. Tex. 1987).

In *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986), the court discussed disregarding the corporate fiction to hold corporate officers liable to corporate creditors, saying that it involves an equitable remedy. Specifically, the court said: "Because disregarding the corporate fiction is an equitable doctrine, Texas takes a flexible

fact-specific approach focusing on equity" (p. 273). This would not normally be the type of technical "fiduciary" duty breach contemplated by § 523(a)(4), although such conduct might be an offense under § 523(a)(6).

In the *Matter of Boyle, supra*, at 587, the court stated:

> . . . Although the language of section 523(a)(4) does not precisely parallel that of its predecessor statute, for purposes of this appeal we assume that Congress did not intend to narrow the substantive content of this particular debt discharge exception by enacting section 523(a)(4), and we apply decisions construing the predecessor section as though they were equally applicable to section 523(a)(4). . . .

See also *Matter of Cross*, 666 F.2d 873, 882 n. 14 (5th Cir. 1982).

The Texas Revised Limited Partnership Act ("TRLPA") (1976) § 6132a-1 VATS states, in § 4.03 (a): "Except as provided by this Act or a partnership agreement, a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners". The Source and Bar Comment under such section provides:

> Section 4.03(a) does not allow the partnership agreement to vary the liability of a general partner to third persons since this might create too much limited liability and imperil partnership status under the federal income tax laws. A general partner in a limited partnership thus has joint and several liability for partnership obligations (TUPA § 15).

The Texas Uniform Partnership Act Art. 6132b ("TUPA") § 15 *Nature of Partner's Liability* states: "All partners are liable jointly and severally for all debts, and obligations of the partnership including those under Sections 13 and 14."

In a non-bankruptcy case, *Foster v. Daon Corp.*, 713 F.2d 148, 151 (5th Cir. 1983), the court stated:

> [3] The Texas Uniform Partnership Act unequivocally states that partners are jointly and severally liable for acts and obligations of the partnership and the partnership is liable for the act of the partners. Tex.Rev.Civ.Stat.Ann., Art. 6132b §§ 13-15 (1970). This being so, plaintiff has a direct right of action against Daon for enforcement of this obligation, without the necessity of first proceeding against the partnership or joining it in her suit.

Defalcation

There is no necessity to show any intentional wrongdoing by a debtor in order to establish that a debt was created by a defalcation. ". . . Finally, while intent is a necessary element of actual fraud, a defalcation may exist when there is a diminution, abatement or deficit in an account as a result of a mistake or negligence in addition to misconduct. *See generally*, 3 Collier on Bankruptcy, § 523.14[b], n. 3-4 (15th ed. 1981)." *Also see, In re Johnson*, 691 F.2d 249, 256 (6th Cir. 1982). "A defalcation is a willful neglect of duty even if not accompanied by fraud or embezzlement." *Matter of Moreno*, —— F.2d —— (5th Cir. 1990).

No. 20 committed a defalcation when it used the $72,000 of the limited partners' funds for repair of the mildew damage.

Bennett Was Not a Fiduciary Under § 523(a)(4) and Therefore Was Not Liable for No. 20's Defalcation in Connection With the Mildew Problem

Matter of Cross, supra, requires the plaintiff claimants ". . . to be *the beneficiary*[*ies*] of a preexisting trust relationship". 666 F.2d at 879. [Emphasis added]. As pre-

viously shown, "fiduciary" applies only to express or technical trusts and does not extend to implied trusts which are imposed on transactions by operation of law. *Davis v. Aetna Accetpance Co., supra.*

No. 20 was the fiduciary of MG and only it had an express, technical, preexisting trust relationship with MG, even though Bennett was the managing partner of No. 20. However, Bennett's individual liability comes into effect only by reason of breach by No. 20, and under TUPA § 15 heretofore quoted. TUPA § 15 makes Bennett liable for No. 20 partnership "obligations," but does not create a fiduciary relationship between Bennett and Plaintiffs. *In re Hurbace, supra*, at 565, it is stated:

> . . . Further, the concept of fiduciary articulated in *Chapman, supra* must exist prior to the act creating the debt and without reference to the act. *See Upshur v. Briscoe*, 138 U.S. 365, 378, 11 S.Ct. 313, 317-18, 34 L.Ed. 931 (1890). As the Supreme Court stated in *Davis*:
>
> > It is not enough that by the very act of wrongdoing out of which the contested debt arose, the bankruptcy has become chargeable as a trustee ex maleficio. He must have been a trustee before the wrong and without reference thereto. In the words of Blatchford, J., 'The language would seem to apply only to a debt created by a person who was already a fiduciary when the debt was created.' (Quoting *Upshur v. Briscoe, supra.*)

See also, In re Weiner, 95 B.R. 204, 205 (Bankr. D. Kan. 1989) As stated in *Matter of Cross, supra*, at 879, for § 523(a)(4) purposes, the Plaintiffs must be the beneficiaries of a trust relationship of which Bennett, not No. 20, was the fiduciary.

Plaintiffs did not plead any § 523(a)(6) cause of action; therefore, the Court does not have to be concerned

with that analysis and Bennett's possible liability for torts. See the tort discussion in *Grierson, supra. Also see, In re Novak*, 97 B.R. 47, 60 (Bankr. D. Kan. 1987); *Scariano Bros., Inc. v. Hammond Const., Div. of Scheyd-Brennan, Inc & Fid. & Dep. Co. of Md.*, 428 So.2d 564 (4th Cir., La. 1983); *9 to 5 Fashions v. Spurney, et al*, 520 So.2d 1276 (5th Cir., La. 1988).

The Leases as Possible Defalcation

The hotel leased various items of equipment. Plaintiffs contend that many of these items of equipment could have been purchased by the general partner before the GM was completed and opened. The items were leased and charged to the partnership (PX 36). As of trial, Plaintiffs alleged that in excess of $800,000 had been spent on such items by the partnership. The Court has previously found that Bennett is not a fiduciary to Plaintiffs within the meaning of § 523(a)(4), but that No. 20 was a fiduciary. In the event the Court is incorrect in its foregoing conclusion, then, to complete the record on this lengthy trial, the Court will make determinations on whether the leases were defalcations if Bennett were a fiduciary to Plaintiffs within the meaning of § 523(a)(4)

It was the obligation of the general partner to equip the establishment so that it could be run as a first-class hotel. The technical services agreement between Marriott and Bennett (DX 72), provided at Tab 10, ¶ 1.1, that owner intended to construct a first-class hotel of approximately 400 guest rooms with related amenities, including public parking, completely furnished and in operating condition. The cost thereof was to be borne by the owner as therein provided. The third clause of such contract references § 3.01 of the management contract (PX 41) as providing that the hotel is to be designed, constructed, furnished and equipped in accordance with plans, specifications, designs, fire and safety standards, and time schedules approved in advance and in writing by Marriott.

Section 3.01A of the management contract (PX 41) references the owner (at that time Bennett) and states as follows:

> A. Owner shall, at its sole cost and expense, under a financing plan mutually agreed upon by Owner and the Management Company, construct on the site ("Site") described in Exhibit A a hotel building, fully equipped, in accordance with the provisions of a technical services agreement ("Technical Services Agreement") between Owner and the Management Company (or one of its affiliated companies) executed concurrently herewith, and otherwise in accordance with plans, specifications, construction safety and fire safety standards, designs and time schedules approved in writing by the Management Company. The Site, the improvements and all fixtures, furnishings, equipment and supplies installed therein are collectively referred to in this Agreement as the "Hotel."

Paragraph 3 of the initial letter dated September 27, 1979, from Mariner Interests, Inc., regarding the project (PX 1) provides as follows:

> Mariner will be responsible for obtaining a first mortgage loan in the amount of $18,000,000 at an 11.21 constant. Mariner will also be responsible for acquiring the land, arranging for the interim loan, architecture and engineering, construction, interior design, acquisition and placement of furniture, fixtures and equipment, landscaping and all other aspects of the development process such that the partnership will be delivered essentially a turnkey project.

Under Paragraph 2.1(a)(4) of the partnership agreement (PX 2, p. 5), the rights of the owner in the management agreement was transferred to the partnership.

Bennett's uncontroverted testimony at trial was that the general partner was a party to only two leases relating

to the Hotel. The two leases (or purchase money security interests), which were authorized by the lender in the Construction Loan Agreement (DX 71, Tab 3, ¶ 7.11), which was incorporated into the Partnership Agreement as Exhibit "C," were a sign lease and a lease for telephone equipment.

Bennett credibly testified that full service hotels like the Marriott generally lease telephones and signs. However, Bennnett further testified that, when he sent the disclosure letter to the investors, he did not remember whether he intended to lease the telephones and signs. On cross-examination, Bennett testified he could have bought the telephones and signs. Except for allegedly improperly expensing the lease costs to the partnership rather than taking purchase costs out of the construction funds, there was no evidentiary comparison of the other economic advantages of either approach or the relative costs of various maintenance approaches, *e.g.*, purchase with maintenance agreement, or lease with maintenance agreement. Article 1.6(b) of the Partnership Agreement (PX 2) authorized the Partnership to lease personal property in connection with the Partnership's business. The Construction Loan Agreement (DX 71, Tab 2) is attached to the Partnership Agreement as Exhibit "C" and was an attachment to the Disclosure Letter the limited partners received before they made their investment. In Article 7.11 of the Construction Loan Agreement, the Lender consented to the general partner's lease of, or creation of security interest for, telephones and signs for the hotel, should the general partner decide to go that route.

In any event, the Limiteds were advised by receipt of such exhibt that in all likelihood there might be continuing obligations (post original construction) for lease or security interest payments in connection with signs and telephone equipment. However, it is undisputed that neither choice was specifically discussed with them and it

was never discussed whether such authority from the lender for a lease or mortgage on such items adversely impacted No. 20's obligation to Plaintiffs to furnish a turnkey first-class hotel project. A purchase or lease of a telephone system or sign under a purchase money security interest could well be consistent with No. 20's turnkey obligation and future expense items for which it might have consistently, with the turnkey obligation, assumed itself. Under such circumstances, the Court finds that No. 20 had a conflict of interest and did not obtain the consent of the Limiteds to its lease of signs and telephones and charging of same to the partnership, as opposed to paying for same. *In re Decker*, 36 B.R. 452, 458 (D.C. D. N.D. 1983).

The Management Agreement with Marriott Corporation authorized Marriott to enter into leases regarding the hotel. A copy of the Management Agreement was provided to and acknowledged by Plaintiffs in connection with the Disclosure Letter. Plaintiffs put on no evidence as to whether the existence of these leases materially affected their investment.

Burden of Proof on Fairness of a Fiduciary's Transactions Under § 523(a)(4)

'. . . When persons enter into fiduciary relations each consents, as a matter of law, to have his conduct towards the other measured by the standards of the finer loyalties exacted by courts of equity.' *Slay v. Burnett Trust*, 143 Tex. 621, 187 S.W.2d 377, 387 (Tex. 1945), citing *Johnson v. Peckham*, 132 Tex. 148, 152, 120 S.W.2d 786, 120 A.L.R. 720. As stated in Bogert, TRUSTS & TRUSTEES § 543 (2d ed. rev. 1978) ("Bogert"), at p. 204-205, 209-210 and 216:

> Reasons behind the establishment of the loyalty rule by equity are that it is generally, if not always, humanly impossible for the same person to act fairly

> in two capacities and on behalf of two interests in the same transaction.
>
> * * * *
>
> The most common case is where the trustee, while engaged in a business transaction for the trust, attempts at the same time to secure a financial advantage for himself or persons related to him; this is usually forbidden as 'self-dealing.'
>
> * * * *
>
> The duty of loyalty applies to employees and agents of the trustee as well as to the trustee employing them.

In the 1989 annotations to such section in Bogert, it is stated, in part, at p. 46:

> The approval or consent of a beneficiary may relieve the trustee of liability but only if the court finds the trustee had made full disclosure of all facts necessary to enable the beneficiary to protect his interest. Some courts require that full disclosure include the nature of the trustee's self-interest and that the trustee explain to the beneficiary the settlor's legal rights under the facts. The *Prueter* decision, discussed above, illustrates these requirements.

Burden of Proof

In *In re Decker*, 36 B.R. 452 (D. N.D. 1983), the court held that, in a § 523 action, a fiduciary has the burden to show the transaction was fair.

As authority for this proposition, the court cited *Pepper v. Litton*, 308 U.S. 295 (4th Cir. 1939) ("*Pepper*"). There the Supreme Court held that a director's

> dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the

> burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

Id. at 306. However, *Pepper* did not involve a defalcation action, but rather involved a corporate officer's claim against his bankrupt corporation. The Supreme Court upheld the Bankruptcy Court's disallowance of the claim, making the above statement. *Pepper* does state the usual burden for fiduciaries. Section 523 has a well-established burden; the movant has the burden to prove the debt falls within one of the § 523 exceptions. This is consistent with the "fresh-start" policy behind the Bankruptcy Code. *Matter of Cross, supra,* makes this point. *See also, In re Wolfington,* 48 B.R. 920 (Bankr. E.D. Pa. 1985); *In re Gelman,* 47 B.R. 735 (Bankr. S.D. Fla. 1985); and *In re Cowley,* 35 B.R. 526 (Bankr. D. Kan. 1983).

In *In re Decker, supra,* at 458, the court stated:

> [6] In this adversary proceeding to determine the dischargeability of Decker's debt to Black's, Black's had the burden to present evidence of reasonable grounds to believe that Decker's debts to Black's arose out of fraud or defalcation while acting in a fiduciary capacity to Black's. Black's presentation of evidence of Decker's transactions with Blacks' for Decker's personal benefit and to the detriment of Black's provides the reasonable grounds required. The burden of persuasion then shifts to Decker to prove that his transactions with Black's were in good faith and inherently fair from the viewpoint of the corporation and those interested therein, or that he disclosed the facts to all concerned and the other directors or shareholders assented.
>
> The bankruptcy court held that Decker's debts to Black's were fully and accurately reflected upon the books, records, and accounts of Black's, which were

> always available for inspection by interested persons. This appears to be the basis of the bankruptcy court's conclusion that Decker incurred the debt to Black's with the express or implied knowledge or consent of persons interested in Black's business.
>
> [7] This Court holds that full disclosure, required when a director deals with the corporation for his own benefit and to the detriment of the corporation, requires more than bookkeeping entries that the director has reason to believe the other directors or shareholders may not see. Full disclosure requires the director to bring all relevant facts to the attention of interested persons and to seek approval from the other directors or shareholders of the corporation.

In *Matter of Taylor,* 514 F.2d 1370 (9th Cir. 1975) (an Act case involving a fraud dischargeability offense and not a fiduciary § 523(a)(4) problem), the Court stated at p. 1373:

> [3] Accordingly, we hold the burden of proof was on appellant to show that appellee intentionally and purposefully attempted to deceive appellant in obtaining the loan. Although a few cases suggest that the burden of proof changes when a *prima facie* case of falsity has been presented, the true rule is that while the burden of going forward may change, the burden of proof does not. Here, the appellee took the witness stand and obviously persuaded the referee of a lack of intent.

See also, In re Davidson, 104 B.R. 788, 796 (Bankr. N.D. Tex. 1989).

The Management Agreement with Marriott Corporation authorized Marriott to enter into leases regarding the hotel. A copy of the Management Agreement was provided to and acknowledged by Plaintiffs in connection with the Disclosure Letter. Plaintiffs put on no evidence

whether the existence of these leases materially affected their investment.

It appears that the *Taylor* approach, rather than the *Decker* approach is correct, and that, once plaintiff has presented evidence showing reasonable grounds to believe that defalcation by a fiduciary occurred, then the burden of going forward changes to the debtor, but the ultimate burden of persuasion rests on the creditor.

Discussion of Specific Leases as Possible Defalcation

There was a disagreement between Marriott and Mariner over whether Mariner had an obligation to furnish certain equipment to Marriott (PXs 43-45). Under PX 45, Mariner, agreed to furnish: (1) The public area sound system (apparently not described as part of the leases shown on PX 36); and (2) After reciting that Mariner never previously provided Marriott pocket page beepers and two-way radio systems on any prior Marriott job, Mariner states in the correspondence that, as a compromise, these items will be leased for one year and then purchased from the Furniture, Fixtures, and Equipment ("FFE") Escrow Account.

As shown on the listing of FFE (PX 44, p. 3, dated 8/14/89), it was contemplated that a pocket page system was a construction item on this project between Marriott and the then owner as of August 14, 1979. While mobile beepers are shown as a leased item on PX 36, it is not shown by sufficient specific evidence that the pocket beepers and two-way radio system are the same as "mobile beepers" listed on the leased equipment identified on PX 36. See PX 75, which apparently is the Conditional Sales Contract with respect to the G.E. Credit contract (identified on PX 36). In summary, the pocket beepers are found to be items that should have been bought by No. 20, but may instead have been leased; however, the Court cannot determine from this record the approximate amount

of leased cost allocable thereto. It is also not clear from sufficient evidence in this record that pocket beepers and mobile beepers are the same. Therefore, there was no proven defalcation with respect to mobile beepers.

Except where noted below, Plaintiffs' Exhibit 36 was the only specific listing and evidence of allegedly specific improper leases. Also see DXs 74 and 75 which are discussed below.

Following is the Court's determination of whether each of same was a defalcation by No. 20, and, if so, in what amount and the reason for the finding:

PX 36 Equipment Description	PX 44—List of Construction and FFE Items	Whether a Defalcation by No. 20 as Being Improperly Charged Against the Partnership and, if so, in What Amount
Trash Compactor	Item 33—Trash Compactor—FFE	Not a defalcation because this is a 3-year lease expiring in 3/87; Therefore, is appears to be a replacement operational lease properly chargeable against the partnership
Vans	Item 80 Transportation Equipment—FFE	Not a defalcation. Lease expired 12/84; however no beginning date shown. With normal depreciation, this could be a replacement operational lease properly chargeable against the partnership.
Outside Signs—Vendor, Federal Sign	Item 75—Exterior Signs	Bennett testified that the Federal Sign bill was a maintenance contract. This was a 5-year lease expiring 1/86 at $945 per month, or $11,340 per year, or $56,700 total. The underlying agreement was not produced. It is not credi-

		ble that the $945 per month was all maintenance contract or that normally a maintenance contract was not part of an ordinary purchase contract. See discussion above. On this item, there was a $56,700 defalcation by No. 20.
Signs—Vendor, Walter Heller	Item 75—Exterior Signs	$1,311 monthly payment and $15,735 $15,735 annual payment, but no expiration or beginning date shown. Insufficient proof of any defalcation because the dates of payments not shown; therefore, this could be a replacement lease item properly chargeable against the partnership.
Mobile Beepers Vendor, G.E. Credit, see DX 75	See discussion above. This possibly may be item 12, a construction item	No defalcation, see discussion above.
Van/Truck Vendor, Hertz Car Leasing	Possibly Item 80 FFE	This is shown to be a monthly lease of $255, but the date of the lease is unintelligible from the exhibit. It appears that this may be an isolated month to month special purpose lease, and not contemplated as part of the original FFE, but a normal operational expense; therefore, no defalcation by no. 20 is found on this item.
Security System, See DX 74 dated 11/11/80	Items 7 and 8, See DX 74 dated 11/11/80	It appears that the contract was for 30 months at $466.53 per month; therefore, No. 20 committed a defalcation of $13,995.90. It appears this item should have been purchased by No. 20.

Copy Machine Vendor, IBM	Item 34—FFE item	No defalcation shown. The charges shown are $1,296 monthly, expiring 11/84; however, no beginning date is shown. This could be a replacement operational lease properly charged against the partnership.
Postal Machine— Vendor, Pitney Bowes Credit Corp.	Item 34, FFE item	$1,081.20 annual payment on 5-year lease expiring 9/85; therefore, total cost of $5,406 and a defalcation in this amount found for No. 20.
Communication System	FFE item	$2,766.60 annual payment on 5-year lease expiring 11/85. Total cost $13,832.50 and a defalcation in this amount found by No. 20.
PBX System— Vendor, UCS	FFE item	Annual payment of $74,227.08 on 10-year lease expiring 2/91. Bennett testified that this was a maintenance contract. The underlying agreement was not produced. It is not credible that the $6,185.59 per month was all maintenance contract or that a maintenance contract was not ordinarily part of a purchase contract. See prior discussion. On this item, there was a $742,270 defalcation by No. 20.

Total defalcation by No. 20 on leased items as shown in the chart above (See PX 36) is *$832,204.40*.

None of the Plaintiffs appeared or testified at trial, or offered any testimonial evidence that there existed any agreement, whether oral or written, other than the partnership agreement, which defined Bennett's obligations to the Partnership or to the limited partners. No Plaintiffs testified or offered evidence that the partnership agreement was ambiguous, or that their understanding of Bennett's individual duties to the Partnership were anything other than those set forth in the partnership agreement.

Prior to execution of the partnership agreement, Bennett sent the Disclosure Letter and its attachments included substantive, material information relating to the proposed partnership and the proposed partnership agreement. Transmitted with the Disclosure Letter to the potential Plaintiffs, as limited partners, were the following documents:

1. Agreement and Letter of Representations
2. Promissory Note
3. Statistical data and a copy of a letter previously forwarded, as follows:

Exhibit I

—Budget dated 6/1/79 re: 402-room Houston Airport Marriott

Exhibit II

—Data relative to hotel occupancy taxes

Exhibit III

—Projection prepared by Marriott Corporation for internal purposes

Exhibit IV

—Houston Airport Marriott Mechanics of Management

Exhibit V

—Ten Year Return on Equity Analysis

Exhibit VI

—Letter of Dr. Joe Ed McLemore

Exhibit VII

—Construction Loan Agreement dated November 30, 1979 between Connecticut General Life Insurance Company and Mariner/Greenspoint, Ltd.

Exhibit VIII

—Houston Airport Technical Services Agreement between Archie Bennett, Jr. and Marriott Corporation.

The Disclosure Letter concluded that the comment,"If you are in need of additional information to make an informed decision, please contact Mr. Michael F. Hord or William R. Geiler at 961-3333." Plaintiffs presented no testimony that the Disclosure Letter was incomplete, misleading, false or omitted material items that would have been important to their investment decision. Bennett testified that the purpose of the Disclosure Letter was to provide the potential limited partners with as complete a disclosure as possible regarding the proposed partnership.

Plaintiffs each executed an Agreement and Letter of Representations (DX 70), in which they made the following representations and warranties:

> (b) He [the proposed limited partner] has a net worth of at least $500,000 (exclusive of his home, home furnishings, and personal automobiles) and has and expects to continue to have, annual taxable income, some portion of which will be subject to federal income taxes at a rate of not less than 50%

without regarding any taxable income or loss which may be generated by the Partnership.

* * * *

(e) He has received, read, and is familiar with the Disclosure Letter, including the exhibits attached thereto and any amendments thereof, and he confirms that all documents, records, and books pertaining to his investment in the partnership have been made available to him. . . .

(f) The undersigned . . . [has] had an opportunity to ask questions of and receive satisfactory answers from the General Partner's representatives, concerning the terms and conditions of this investment, and all such questions have been answered to the full satisfaction of the undersigned.

* * * *

(k) The undersigned acknowledges that the General Partner has made available to him . . . the opportunity to obtain additional information to verify the accuracy of the information contained in the Disclosure Letter and to evaluate the merits and risks of this investment. . . . The undersigned confirms that he has consulted with his attorney and his accountant and that said attorney and said accountant have analyzed the Partnership Agreement and the documents relating thereto on his behalf. . . .

Plaintiffs were advised of the agreement with the Lender for the GM, the possible tax consequences of an investment in the Partnership, possible savings to the general partner if the hotel came in under $22 million, and the Management Agreement with Marriott Corporation to operate the hotel.

PX 37 states that "Based on the 1983 estimated loss and using a 50% tax rate plus ITC credit, the limited partner will have received $1,007 return for each $1,000

originally invested." Each of the Plaintiffs represented and warranted that he was in the 50% tax bracket.

The hotel was returned to the lender in 1988. This caused tax problems for the limiteds because they had to make allowances for prior losses taken.

Articles 9 and 10 of the Partnership Contract

In Article 10 of the Partnership Agreement, Bennett individually made two warranties. There was no showing that either of these two warranties was breached.

Plaintiffs contend, among other contentions, that, by virtue of the general partner warranties and representations in Article 9, pp. 35 and 36 of the Limited Partnership Contract (PX 2), because of the last paragraph of Paragraph (e) thereof (*i.e.*, if the representations and warranties are not performed, then the limiteds are entitled to their contributions back), they are entitled to all their money back. Setting aside any § 523(a)(4) question of whether Bennett was a fiduciary and also setting aside any question of whether Bennett could be sued individually, there was no showing that paragraph (a) of Article 9, p. 35 was violated. Paragraphs (b) and (c) of Article 9 were complied with. There was no showing that, as of March 1, 1980, the date of the Limited Partnership Agreement, Paragraph (d) of Article 9, was incorrect. Can it be legitimately argued, for example, that taking the $77,000 in mildew costs out of the Limited's partnership funds or any $832,204.40 total lease cost defalcation by No. 20, as heretofore found, brought into effect the non-performance of representations and warranties in Article 9(e), second paragraph, and thus, require return of any investments by the limited partners less any cash flow previously received? It appears not. The "representations" referred to in Article 9(d) appear to be modified by the words ". . . *they* are *projections* only and not actual project costs and operating results may vary substantially". [Emphasis added] Accordingly,

Article 9(e), second paragraph, would not be sufficient legal basis to require the full return by No. 20 of investment to the limiteds, less prior distributions.

Damages

The Court has previously found that, insofar as these Plaintiffs are concerned, Bennett is not a fiduciary within the meaning of § 523(a)(4), and, therefore, no damages under § 523(a)(4) would be appropriate against him. If the Court is found to be incorrect on this pivotal conclusion, it would be advantageous for the parties who have fully developed the record, and the Appellate Court to have damage findings set forth as part of this opinion. Plaintiffs contend that they would be entitled to full restitution of their entire investment in the event of a defalcation, regardless of whether the defalcation was for $10 or $10 million. Citing, *Crenshaw v. Swenson*, 611 S.W. 2d 886 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.) ("*Crenshaw*"); and *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex. Civ. App.—Austin 1978 writ ref'd n.r.e.) ("*Watson*").

The damage issue is straightforward and would not be complicated if it were not for the seminal case of *Watson, supra*. There, the Austin Court of Appeals, in awarding restitution, held that it was not necessary that there be proximate cause between the breach and the damages awarded because the fiduciary breached his duties, and, thus, the limited partners were entitled to restitution of their entire investment as a matter of law. In support, the court cited *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corporation*, 160 S.W.2d 509 (Tex. 1942); *Anderson v. Griffith*, 501 S.W.2d 695 (Tex. Civ. App.—Fort Worth 1973, writ ref'd n.r.e.); and *Russell v. Truitt*, 554 S.W.2d 948 (Tex. Civ. App. Fort Worth 1977, writ ref'd n.r.e.). In *Crenshaw, supra*, at 891, the court stated, ". . . courts are ill-equipped to discern the extent a conflict of interest *may* have affected the outcome of any given transaction. . . ."

The cases cited in *Watson* only held that, if a fiduciary breaches his duties, he forfeits his *right to compensation* as a matter of law, without regard to whether there is proximate cause between the breach and the damages. Those cases do not hold that the injured beneficiaries of the fiduciary relationship are entitled to *restitution of their entire investment,* without regard to proximate cause.

As further support, the *Watson* court cited Dobbs, *Remedies* (1973), §§ 4.1 and 10.4. Section 10.4 speaks of remedies for breach of a fiduciary relationship. The explanation uses the word "restitution". However, in reading that explanation, it is clear that Dobbs is using restitution as disgorgement of profits. In speaking of restitution in § 10.4, Dobbs says that the aim of restitution is the prevention of unjust enrichment. *Watson* also cites Dobbs § 4.1, which speaks about restitution in general. This section specifically speaks of restitution in the context of unjust enrichment and not just rescission of the entire contract.

The *Watson* court, at p. 182, also held that restitution is not the only remedy.[1] Thus, even if *Watson* is correct Texas law, restitution would only be one type of remedy to which courts may turn.[2]

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[1] For other general authorities on available remedies for breach of trust, see, Scott on Trusts, § 205 (4th ed. 1988); Tex.Jur.3d §§ 160, 175, and 220; Am.Jur.2d on Trusts § 304, pp. 578-584; and the following Bankruptcy Court decisions: *In re Gelman,* 47 B.R. 735 (Bankr. S.D. Fla. 1985); *Matter of Thomas,* 34 B.R. 103 (E.D. Wis. 1983), rev'd. 729 F.2d 502 (7th Cir. 1984); *In re Weiner,* 95 B.R. 204 (Bankr. D. Kan. 1989); *In re Kwiat,* 62 B.R. 818 (Bankr. D. Mass. 1986); *In re Patton,* 58 B.R. 149 (W.D. N.C. 1986). Also see, *Palmer v. Fuqua, supra,* which involved a non-§ 523(a)(4) case breach of a fiduciary duty by the general partner. Although not excluding restitution, the court speaks of imposition of a constructive trust on the gain as the appropirate remedy, as well as exemplary damages.

[2] *Crenshaw, supra,* at 892. The same court that decided *Watson* held that the limited partners were entitled to equitable restitution

The cases seem clear that what is allowed is just what the statute holds: "any debt . . . for fraud or defalcation while acting in a fiduciary capacity. . . ." The debt must be directly related to the damages caused by the defalcation. The *Patton* court also held that damages includes damages imposed by state law. *In re Patton, supra.*

The party seeking to establish an exception to discharge has the burden of proof. *In re Martin,* 698 F.2d 883, 887 (7th Cir. 1983); *In re Luce,* —— B.R. —— (Bankr. N.D. Tex. 1989); *In re John Iaquinta,* 1989 Bankr. LEXIS 640, 98 B.R. 919 (Bankr. N.D. Ill. 1989).

A plaintiff must introduce sufficient evidence to provide a trier of fact with an intelligent means in determining an appropriate damage award without speculation or conjecture. *Feldman v. Pioneer Petroleum, Inc.,* 813 F.2d 296, 301 (10th Cir. 1987); *In re Novak,* 97 B.R. 47 (Bankr. D. Kan. 1987).

If Bennett were liable for damages to Plaintiffs herein, which the Court finds he is not, for the reasons stated, then the most accurate assessment of Plaintiffs' § 523(a)(4) genuine damages, rather than complete restitution of Plaintiffs' investment, would be their respective limited partnership ownership percentage multiplied by the specific "defalcation" found.

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of their investments. No authorities were cited, nor was their any mention of proximate cause. *Watson* was cited earlier in the *Crenshaw* opinion, but only for the proposition that managing partner is a fiduciary.

Kirby v. Cruce, 688 S.W.2d 161 (Tex. Civ. App.—Dallas 1985, writ ref'd n.r.e.). The court held that investors were entitled to restitution of their investment due to a breach of fiduciary duty. However, the Appellate Court noted, at p. 166, that "these damages resulted from appellants' reliance upon the appellees' fraudulent representation". Thus, it differs from *Watson* in that there was a finding of proximate cause.

In the Bogert 1989 pocket part annotations at pp. 53 and 54, it is stated:

> The *Restatement of Trusts* and a growing number of court decisions suggest somewhat different rules as to liability and damages in conflict cases which do not involve flagrant acts of self-dealing; the complainant may be required to establish not only a breach of the duty of loyalty but prove loss to the trust and a causal connection between the breach and the loss. Implicit in these rules is the requirement that the loss be directly traceable to the breach of trust and that the loss would not have occurred but for the breach of trust. The court's determination as to which party bears the initial burden of proof may determine the outcome of the case; if the trustee is required to show prudence and good faith in his execution of the trust the beneficiary's chances of recovery may be increased. Though many courts have held the trustee liable for the entire loss without attempting to measure other possible cases of the loss, some have required proof of a direct causal relation between the breach and the trust's loss. If the beneficiary seeks to recover damages for one or more breaches of trust, and both liability and loss are easily determined, the court may have little trouble finding such casual relation.

Judgment will be entered in accordance with the foregoing opinion.

SIGNED: February 23, 1990.

s/ Robert C. McGuire
ROBERT C. McGUIRE
U.S. Bankruptcy Judge

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF: ARCHIE BENNETT, JR.,

LSP INVESTMENT PARTNERSHIP, *et al.*,
Appellants,

versus

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court for the
Northern District of Texas

ON PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING EN BANC

[Filed May 21, 1993]

(Opinion 04/19 93, 5 Cir., 1993, —— F.2d ——)

(May 21, 1993)

Before POLITZ, Chief Judge and HIGGINBOTHAM, Circuit Judges, and PRADO,* District Judge.

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* District Judge of the Western District of Texas, sitting by designation.

PER CURIAM:

(✓) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestion for Rehearing En Banc is DENIED.

( ) The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ Henry A. Politz
United States Chief Judge

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF: ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE,
Appellants,

versus

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court for the
Northern District of Texas, Dallas Division

ARCHIE BENNETT'S RESPONSE IN
OPPOSITION TO MOTION TO RECALL MANDATE

[Filed October 6, 1993]

TO THE HONORABLE JUSTICES OF THE FIFTH CIRCUIT:

Archie Bennett, Jr. ("Mr. Bennett or Appellee") files this Response in Opposition to Motion to Recall Mandate (the "Response") contending (i) Appellants' motion seeks relief previously requested and denied and (ii) that postjudgment interest should only be considered from the date this Court rendered judgment for the first time on appeal.

1. On September 27, 1993, the Appellants filed a Motion to Recall Mandate requesting the Court withhold and modify or reissue the Court's Mandate issued on September 13, 1993. Appellee opposes the relief and contends it is inappropriate under the factual and procedural circumstances of this case.

2. The Court's Mandate of September 13, 1993, follows a rather extraordinary history in this appeal. The Mandate confirmed an earlier decision of the Court dated April 19, 1993, later modified July 15, 1993, whereby on Appellants' motion for rehearing this Court reversed an unbroken string of decisions by the bankruptcy court, district court and this Court in favor of Appellee and rendered judgment for the first time in favor of Appellants.

3. This Court's self reversal and issuance of judgment against Appellee on April 19, 1993, comprised the first instance whereby Appellee was held subject to a "judgment" against him from which postjudgment interest might accrue. Prior to that date, Appellee had been held discharged from this liability. Appellants never raised the issue of interest in this appeal at any stage until *after* this Court issued and then modified its April 19, 1993 judgment, at which time this Court considered and did not award interest to Appellants.[1] Consequently, under FED.

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[1] Appellants' Motion to Recall Mandate raises the same argument for postjudgment interest urged by Appellants before the Man-

R. APP. P. 37, postjudgment interest is only appropriate from and after the Court's April 19, 1993 issuance of a judgment.

4. Appellants cite Local Rule and prior opinions of the Court as precedent that recall of the Mandate is proper to "prevent injustice." *See* Local Rule 41.2 and *In re Incident Aboard the d/B Ocean King*, 877 F.2d 322, 324, 326 (5th Cir. 1989). This proposition is inapplicable to the present circumstances. There was no judgment prior to April 19, 1993 from which postjudgment interest could accrue. Appellants raised the issue of an earlier entitlement to postjudgment interest for the first time well after the Court rendered and modified its April 19, 1993 judgment. Now, Appellants again raise this same issue after the Court did not award such interest and issued the Mandate. The Court has held on numerous occasions that issues not timely raised on appeal are waived and will not be entertained by the Court. *See United Paperworkers Int'l Union v. Champion Int'l*, 908 F.2d 1252, 1255 (5th Cir. 1990) ("an appellant abandons all issues not raised in its *initial* brief.") (emphasis added); *Texas Mortgage Servs. Corp. v. Guadalupe Sav. & Loan Ass.*, 761 F.2d 1068, 1073 (5th Cir. 1985) (issues not raised or argued in the brief of the appellant may be considered waived and thus will not be noticed or entertained by the court of appeals.") Therefore, the issue of awarding interest from a date prior to this Court's rendition of judgment on April 19, 1993 should not be reheard now. If interest should accrue, it should accrue *only* from and after the date this Court first rendered judgment in favor of Appellants. Appellants are retreading the same argument raised, briefed and presented to this Court before the Mandate was issued. Now, there is nothing new to support or cause reconsideration of the Court's

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date issued. *See* Appellants' Reply: Motion to Clarify Judgment, filed July 27, 1993. The Court's response was to issue Mandate on its judgment.

prior refusal to grant Appellants the relief first raised after judgment and before the Mandate was issued.

WHEREFORE, Appellee requests the Court not recall its Mandate and otherwise deny Appellant's relief.

Respectfully submitted this 5th day of October, 1993.

VERNER, LIIPFERT, BERNHARD,
MCPHERSON AND HAND CHARTERED

/s/ Lenard M. Parkins
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Attorneys for Archie Bennett, Jr.

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
OFFICE OF THE CLERK

Richard E. Windhorst, Jr.
Clerk

Tel. 504-589-6514
600 Camp Street
New Orleans, LA 70130

September 28, 1993

TO: COUNSEL FOR APPELLEE

No. 91-1059—LSP INVESTMENT v. BENNETT
(D.C. No. CA3-90-0766-G)

In regards to the case identified above, the following motion has been filed:

APPELLANTS' MOTION TO RECALL MANDATE

This motion will be presented for ruling *without oral argument* on this date: OCTOBER 5, 1993

Any response to the motion must be filed by opposing counsel on or before that date to be considered in the ruling.

The date shown above indicates when the matter will be forwarded for ruling and does not mean that any action will be completed by then. Counsel should allow at least ten (10) days thereafter before inquiring about the Court's ruling.

Very truly yours,

RICHARD E. WINDHORST, JR.
Clerk

By: /s/ Marianna Tomeny/ag
Deputy Clerk

Mr. D. Mitchell McFarland
Mr. Lenard M. Parkins

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE,

Plaintiffs-Appellants,

VS.

ARCHIE BENNETT, JR.,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Texas, Dallas Division

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APPELLANTS' MOTION TO RECALL MANDATE

TO THE HONORABLE COURT OF APPEALS:

This Court's mandate, which issued on September 13, 1993, does not contain an instruction concerning interest. Rule 37 of the Federal Rules of Appellate Procedure, however, expressly requires that "[i]f a judgment is modified or reversed with a direction that a judgment for money be entered in the district court, the mandate *shall* contain instructions with respect to the allowance of inter-

est." (Emphasis added). That requirement is explicit, mandatory, and unambiguous. Appellants, moreover, specifically requested such an instruction before this Court issued its mandate. *See* Appellants' Motion to Clarify Judgment.

At the least, this Court should recall and modify its mandate to instruct the district court that post-judgment interest should accrue from December 14, 1990, the date on which the district court entered its original, erroneous judgment. Otherwise, Appellants will be penalized for the district court's error.

That penalty is especially egregious because the issue raised in this appeal was whether Appellee, Archie Bennett, Jr., who defalcated funds in violation of his fiduciary duties, could be discharged in bankruptcy from his debt to those fiduciaries. This Court determined that Bennett could not be discharged. Unless this Court provides an instruction on interest, however, Bennett, although not discharged, will avoid the accrual of any interest on those debts, some of which have been owing for over a decade.

As the Advisory Committee Notes on the Appellate Rules explain, Rule 37 was meant to eliminate questions concerning the "whether interest is to run from the date of entry of the judgment directed by the court of appeals or from the date on which the judgment would have been entered in the district court except for the erroneous ruling corrected on appeal." Advisory Committee Notes to Fed. R. App. P. 37. That is precisely the question that this Court's mandate leaves open.

Recall of the mandate, moreover, is an appropriate remedy when a party "conceives himself entitled to interest from a date other than the date of entry of judgment in accordance with the mandate." *Id.* Local Rule 41.2 permits this Court to recall its mandate in order to "prevent injustice," and this Court has invoked that rule on many occasions in order to recall a mandate that did not

contain an instruction on interest. *See e.g., In re Incident Aboard the D B Ocean King*, 877 F.2d 322, 324, 326 (5th Cir. 1989) (recalling and reforming the mandate in order to provide for the recovery of interest); *Martin v. Walk, Haydel & Associates, Inc.*, 794 F.2d 209, 210-11 (5th Cir. 1986) (recalling and reforming mandate in order to include instruction on interest); *Home Life Ins. Co. v. Equitable Equipment Co., Inc.*, 694 F.2d 402 (5th Cir. 1982). *See also Briggs v. Pennsylvania Railroad Co.*, 334 U.S. 304, 68 S.Ct. 1039 (1948); *Leroy v. City of Houston*, 906 F.2d 1068, 1074 (5th Cir. 1990); *Gele v. Wilson*, 616 F.2d 146, 149 (5th Cir. 1980). These cases recognize that a failure to award interest from the date of the erroneous judgment works an injustice. *See, e.g., In re Incident Aboard the D B King*, 877 F.2d at 326. Appellants request that this Court modify its mandate in order to prevent such an injustice in this case.

WHEREFORE, Appellants respectfully request that this Court recall and reform its mandate to instruct the district court to award post-judgment interest from the date of the district court's original, erroneous judgment.

DATED this 27th day of September, 1993.

Respectfully submitted,

By s/ D. Mitchell McFarland
D. MITCHELL MCFARLAND
James E. Essig
LIDDELL, SAPP, ZIVLEY, HILL & LABOON, L.L.P.
3300 Texas Commerce Tower
Houston, Texas 77002
(713) 226-1200

Attorneys for Plaintiffs Appellants

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
OFFICE OF THE CLERK

Richard E. Windhorst, Jr.
Clerk

Tel. 504-589-6514
600 Camp Street
New Orleans, LA 70130

September 13, 1993

Mrs. Nancy Hall Doherty, Clerk
U.S. District Court
Dallas, TX

No. 91-1059—LSP INVESTMENT vs BENNETT
(D. C. No. CA3-90-0766-G)

(X) Enclosed to you only is a certified copy of the judgment of this Court in the above case issued as and for the mandate.

( ) Enclosed to you only is a certified copy of the Rule 47.6 Decision in the above case issued as and for the mandate.

( ) The Court having denied the motion for stay of mandate, enclosed to you only is a certified copy of the judgment of this Court in the above case issued as and for the mandate.

( ) Having received from the Clerk of the Supreme Court a copy of the order of that Court denying certiorari, I enclose a certified copy of the judgment of this Court in the above case, issued as and for the mandate.

Enclosed herewith are the following additional documents:

(X) Copy of the Court's opinion.

( ) Original record on appeal or review. ( ) Volumes
TO BE RETURNED SHORTLY

( ) Other original papers forwarded with record.
( ) Envelope ( ) Box

( ) Bill of Costs approved by this Court.

( ) Copy enclosed to counsel.

Sincerely,

RICHARD E. WINDHORST, JR.
Clerk

By: /s/ Marianne Tomeny
Deputy Clerk

cc: (Letter Only)
Judge A. Joe Fish
Mr. D. Mitchell McFarland
Mr. Lenard M. Parkins

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE,

Plaintiffs-Appellants,

VS.

ARCHIE BENNETT, JR.,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

APPELLANTS' REPLY: MOTION TO CLARIFY JUDGMENT

TO THE HONORABLE COURT OF APPEALS:

Appellants merely seek an instruction on interest as required by Fed. R. App. P. 37, which states: "If a judg-

ment is modified or reversed with a direction that a judgment for money be entered in the district court, the mandate *shall* contain instructions with respect to the allowance of of interest." (Emphasis added). This Court's mandate, which does not contain such an instruction, should at least inform the trial court whether postjudgment interest will run from the date of the first judgment or from the date of this Court's ruling. *See e.g., Briggs v. Pennsylvania Railroad Co.*, 334 U.S. 304, 68 S.Ct. 1039 (1948); *Leroy v. City of Houston*, 906 F.2d 1068, 1074 (5th Cir. 1990); *Gele v. Wilson*, 616 F.2d 146, 149 (5th Cir. 1980).

This Court often has provided that postjudgment should run from the date of the original judgment. *See e.g., In re Incident Aboard the D B Ocean King*, 877 F.2d 322, 326 (5th Cir. 1989) (recalling mandate in the interests of justice so that trial court could award interest from the date of the trial court's original judgment). The rationale for these decisions seems especially appropriate in this case: that the plaintiff should not be punished because the trial court entered an erroneous judgment that required a substantial amount of time to correct on appeal. *Id.*

Furthermore, Appellants are entitled to prejudgment interest as a matter of law—a proposition that Appellee, Archie Bennett Jr. ("Bennett"), has not questioned. Rather, Bennett argues that Appellants waived their right to prejudgment interest because they failed to raise the denial of prejudgment interest as an issue on appeal.

Appellants, however, were not obliged to raise this issue on appeal because no court *denied* their request for prejudgment interest, which they sought at paragraphs 19, 20, and 21 of their Complaint. Bennett nevertheless contends that Appellants should have anticipated that the district court, had entered judgment in Appellants' favor, would have denied prejudgment interest because the bank-

ruptcy court, in its contingent damages calculation, did not address the question of prejudgment interest.

Neither the bankruptcy court's contingent damages calculation, however, nor the district court's affirmance of the bankruptcy court's denial of relief, were final judgments denying prejudgment interest from which Appellants could have, or should have, appealed. Appellants, therefore, respectfully request that this Court instruct the district court to award postjudgment interest from the date of the original judgment until paid, and to award prejudgment interest from the date of injury until the date of judgment.[1]

DATED this 27th day of July 1993.

Respectfully submitted,

By /s/ James E. Essig
D. MITCHELL MCFARLAND
JAMES E. ESSIG
LIDDELL, SAPP, ZIVLEY, HILL & LABOON, L.L.P.
300 Texas Commerce Tower
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(713) 226-1200

Attorneys for Plaintiffs/Appellants

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[1] At the least, this Court should allow the district court to consider Appellants' request for prejudgment interest. *See In re Incident Aboard the D/B Ocean King*, 877 F.2d at 324-25 (trial court should be given instructions, or at least permission, to award prejudgment interest).

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF: ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE,
Appellants,

versus

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

ARCHIE BENNETT'S RESPONSE TO APPELLANTS' MOTION TO CLARIFY JUDGMENT

[Filed July 26, 1993]

TO THE HONORABLE JUSTICES OF THE FIFTH CIRCUIT:

Archie Bennett, Jr. ("Mr. Bennett") files this Response to Appellants' Motion to Clarify Judgment (the "Response"), and respectfully states as follows:

A. INTRODUCTORY STATEMENT AND PROCEDURAL HISTORY

1. Appellants' Motion to Clarify Judgment ("Appellants' Motion") asks the Court to award interest to which Appellants are not entitled. The Court has already ruled on this issue through entry of its amended judgment. All matters and issues again raised in Appellants' Motion have already been fully briefed and ruled upon by this Court on July 15, 1993. There must be finality on this issue.

2. The Court directed that the Appellants file a response to Mr. Bennett's Second Petition for Rehearing concerning the calculation of damages in this case. Appellants did so ("Appellants' Response") and on June 16, 1993, they conceded that Mr. Bennett has been right all along: at best the Appellants were entitled to only 28% of the total damages suffered by the partnership. In addition, in the Appellants' Response and for the *first time* on any appeal (whether to the district court or before this Court), Appellants, after reluctantly admitting the correctness of Mr. Bennett's damages calculation, asked the Court to *sua sponte* compute prejudgment interest on this Court's final assessment of damages even though Appellants *never* raised the issue of prejudgment interest (i) during the bankruptcy court trial either in argument of counsel or evidence (Record at pp. 1 to 554); (ii) in their brief to the district court on appeal as an issue for review or otherwise; and (iii) in their original brief and petition for rehearing filed with this Court.

3. If Appellants thought the bankruptcy court committed error in not including interest in its damages calcu-

lation against Mr. Bennett, then Appellants should have raised that issue on appeal. They did not. Their right to claim interest as part of the damages calculation has been waived. On July 15, 1993, after approximately three weeks of considering Mr. Bennett's Second Petition for Rehearing and Appellants' Response thereto, this Court concluded that Appellants are only entitled to damages in the amount of 28.4375% of $1,904,204.40 and *no* prejudgment interest was awarded. Appellants raised the interest issue, briefed it, and this Court ruled against Appellants' Claim. By filing Appellants' Motion, Appellants are seeking to obtain a windfall at Mr. Bennett's expense by asking the Court to again reconsider its damages award under the guise of clarifying a judgment which is perfectly clear on that very issue—Appellants are entitled to the damages awarded and no other relief. As this Court has made plain by its July 15, 1993 ruling, and under established Fifth Circuit law, Appellants are not *now* entitled to raise or obtain prejudgment interest from this Appellate Court.[1] For these reasons, the Court should deny Appellants' Motion to ensure a fair and proper result, hopefully for the last time.

B. APPELLANTS HAVE WAIVED THEIR ENTITLEMENT TO PREJUDGMENT INTEREST BECAUSE APPELLANTS NEVER TIMELY RAISED THIS ISSUE IN THEIR BRIEF ON APPEAL

4. Bankruptcy Rule 8002 defines the procedure Appellants were required to follow to preserve issues on appeal to the district court. Appellant noticed an appeal to the

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[1] This Court concluded in its ruling in September 1992 as modified in its April 1993 ruling that the bankruptcy court appropriately determined damages in this case. Appellants never asked the district court or this Court on appeal to determine damages or remand the case to the bankruptcy court to redetermine damages. Indeed, Appellants never asked the bankruptcy court to clarify its judgment to include an interest element.

bankruptcy court only on issues other than the findings on entitlement to interest on the damages, which findings did not include an award for interest. Bankruptcy Rule 8006 further required Appellants, if a timely appeal had been filed, to file their own statement of issues. Appellants did not raise or appeal the issue of the entitlement of interest. Whether the bankruptcy court's damages award was improper for failure to award interest was thus not an issue at the district court, and therefore is not now an issue before this Court.

5. FRAP 28(a) designates what must be contained in a brief prepared by an appellant to this Court. This rule has been uniformly construed by appellate courts to mandate that the brief of an appellant contain *all* issues presented for review. *See* 16 C. Wright, A. Miller, E. Cooper & E. Gressman, *Federal Practice and Procedure* § 3974, at 421 (1977). As a consequence, it has been stated by this Court on numerous occasions that issues "not raised or argued in the brief of the appellant may be considered waived and thus will not be noticed or entertained by the court of appeals." *Texas Mortgage Servs. Corp. v. Guadalupe Sav. & Loan Ass. (In re Texas Mortgage Servs. Corp.)*, 761 F.2d 1068, 1073 (5th Cir. 1985) ("Without reaching the merits of appellant's argument, we find that this issue has been waived."), *citing, Cannon v. Teamsters & Chauffeurs Union*, 657 F.2d 173, 177-78 (7th Cir. 1981) ("it would be patently unfair for the court to consider the new issue as properly before it since the other side had not been given advance warning that the issue would be raised.").[2]

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[2] *See also United Paperworkers Int'l Union v. Champion Int'l*, 908 F.2d 1252, 1255 (5th Cir. 1990) ("an appellant abandons all issues not raised in its *initial* brief."); *Travelers Indem. Co. v. Atlantic Express Line*, 837 F.2d 187, 188 (5th Cir. 1988) (Here, this even included a refusal to address an asserted due process claim raised at trial, where party "did not get to it during trial" or raise it in its brief.)

6. Before this latest (and hopefully last) stage of the appellate process, no mention of prejudgment interest was ever previously made by Appellants for the duration of all appeals. Appellants, however, attempting to mislead this Court, stated in their Motion that Appellants requested "prejudgment interest in their pleadings in the bankruptcy and the district court." This is a blatant prevarication. Appellants did ask for interest in their Complaint to Determine Dischargeability of Debt filed with the bankruptcy court on February 15, 1989. Appellants lost at the trial court and *never* again raised the issue of their right, entitlement or claim to interest as part of their damages claim at any time or before any court until June 18, 1993 when they filed Appellants' Response. In Appellants' brief to the district court, they never requested interest of any kind. Rather, they asked only for full restitution objecting to the bankruptcy court's alternative award of actual damages. Attached hereto as Exhibit "A" is the excerpt containing Appellants' damages argument presented to the district court in their brief. No appellate issue of interest has ever been raised by the Appellants. Therefore, Mr. Bennett can only assume that "district court" as referred to in Appellants' Motion means the Texas state district court lawsuit in Harris County, Texas, which lawsuit was first filed by Appellants in 1984, approximately five years before Appellants' commenced their adversary proceeding in the bankruptcy court. For purposes of this appeal, contentions made by Appellants in pleadings filed in the Texas state district court years prior to the commencement of Appellants' adversary proceeding are irrelevant and are not the subject of this appeal. Aside from Appellants' Complaint filed with the bankruptcy court (*see* Complaint at ¶¶ 19-21), Appellants' entitlement to prejudgment interest has never been raised (i) during trial [3] (*see* Transcript of Hearing to Determine Discharge-

[3] As in *Travelers Indem. Co., supra*, they apparently just "didn't get to it during trial."

ability before Honorable Robert C. McGuire); (ii) nor in Appellants' brief on appeal to the district court (*see* Brief of Appellants to United States District Court); (iii) nor in their brief to this Court (*see* Brief of Appellants to United States Court of Appeals for the Fifth Circuit); and (iv) not in their petition for rehearing to this Court (*see* Appellants' Petition for Rehearing. The bankruptcy court's damages calculation and judgment did not award Appellants interest and Appellants simply never took that issue up on appeal. Moreover, in the recent July 15, 1993 ruling, this Court did not award Appellants prejudgment interest. Until this point in the appellate process, Appellants have accepted the bankruptcy court and this Court's calculation of damages, and have never sought by argument, post trial motion or cross appeal to have prejudgment interest recognized either by the bankruptcy court or on appeal. Without belaboring the issue, it is undeniably clear on this record that Appellants have not preserved any right to contend they are entitled to prejudgment interest because Appellants failed to properly present the issue on appeal to the district court and then to this Court in accordance with Rule 28(a) of the Federal Rules of Appellate Procedure.

7. Notwithstanding the Appellants' newly discovered candor in accepting the 28.4375% limitation as correct, Appellants continue to press the Court to render much higher damages inconsistent with established Fifth Circuit law and this Court's July 15, 1993 ruling on damages. Appellants compound the injustice by filing their meritless Motion for a claim for prejudgment interest never presented at trial, in argument or through evidence, much less preserved on appeal. As Appellants' eloquently stated in Appellants' Reply to Bennett's Response Concerning Calculation of Damages, "this appeal must have an end." Mr. Bennett agrees with Appellants that the appeal before this Court must have an end notwithstanding Mr. Bennett's belief that even the Court's latest award continues

a mistaken double recovery of the $904,000 in damages otherwise found by the bankruptcy court. This Court has considered and reconsidered the issues of damages in this case and Appellants have already presented (although tardy) and this Court has already ruled upon their request for prejudgment interest.

8. The basis of Appellants' Motion does not change the result dictated by years of precedent and established appellate procedures. Appellants now cite *Cavnar v. Quality Control Parking,* 696 S.W.2d 549, 554 (Tex. 1985) and its progeny as authority supporting Appellants' contention that they are entitled to prejudgment interest for the first time on appeal. *Cavnar* and its progeny, however, have never stood for the proposition that an appellant is entitled to prejudgment interest when that issue has not been properly brought or preserved on appeal. Rather *Cavnar,* and its progeny only address how to compute prejudgment interest when prejudgment interest is requested and awarded at the trial level. *Cavnar,* 696 S.W.2d at 554. This is simply not the case here.

9. Appellants also cite *Phillips Petroleum Co. v. Oldland,* 187 F.2d 780, 782 (10th Cir. 1951), *cert. denied,* 342 U.S. 816 (1951) as authority to support Appellants' proposition that they should not lose their right to prejudgment interest. *Phillips* does not stand for this proposition. In *Phillips,* no request for interest was ever claimed in the original suit, and the trial court had no occasion to consider that question. To ask this Court to now reconsider awarding prejudgment interest in direct contravention of clear Fifth Circuit case law that says it will not address issues never preserved on appeal is without basis.

10. Mr. Bennett earnestly believes that the issue of damages is only further clouded by the Appellants' meritless contention at this stage of the appellate process. Respectfully, this Court must consider the manifest injustice

and harsh result that will result to Mr. Bennett *for the rest of his life* and to anyone else ever similarly situated if the Court entertains consideration of prejudgment interest at this late juncture and does not reconsider and correct its ruling on damages which can *never* be discharged. Mr. Bennett therefore respectfully petitions the Court to deny Appellants' Motion and refuse, as a matter of law, to reconsider the issue of prejudgment interest when such would be absolutely contrary with the Court's affirmation of the bankruptcy court's fact finding on this point.

11. Appellants' tardy claim unjustly attempts to enrich the Appellants for prejudgment interest which Appellants have not preserved as a matter of law.

WHEREFORE, Mr. Bennett prays the Court deny Appellants' Motion and grant such other and further relief as is just, proper and equitable.

Respectfully submitted this 26th day of July, 1993.

VERNER, LIIPFERT, BERNHARD,
MCPHERSON and HAND, CHARTERED

/s/ Trey A. Monsour
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Appellants, and that this fiduciary relationship, under Texas law, rose to the level of the fiduciary duty a trustee owes to its beneficiaries.

C. *Bennett Took the Money*

The holding by the court ignores reality, elevating form over substance. Bennett was the human being who controlled the actions of No. 20 and M/G. No other person was available. The only person who could and did decide to: (1) do nothing to solve the negative pressure problem, (2) do nothing to alter the design of the hotel when warned by Marriott, (3) fail to furnish equipment, but charge the partnership for equipment rental, (4) take $1,000,000 as "savings" despite the above and (5) charge the partnership for the cost of mildew repairs.

Bennett, not No. 20, got the $1,000,000 distribution. This was an additional defalcation not found by the court below. Bennett intentionally arranged for the employment of an unbondable contractor so that the Greenspoint Marriott project could be completed under budget by $1,000,000. Bennett stacked the cards so that he would receive the distribution. He ignored mistakes inherent in the design of the hotel. He installed defective air conditioning equipment. (Ex. 33, 34). Bennett did not satisfy his obligation to the limited partners to deliver a first-class hotel and, yet, still took $1,000,000 out of partnership funds, for himself.

By applying settled principles of law established above, this court should find that Bennett committed an additional defalcation when he arranged for the distribution of the $1,000,000 to himself. The court below found that No. 20 defalcated over $900,000 which, based on the record and the law, was clearly the act of Bennett. However, the $1,000,000 distribution in 1981 should never

have been made and it is an additional defalcation to be added to the amounts found by the court below.

II. THE BANKRUPTCY COURT'S CONTINGENT CALCULATIONS OF DAMAGES ARE IN ERROR

Nearly half of the bankruptcy court's Memorandum Opinion anticipates that its decision will be reversed upon appeal. To that end, the bankruptcy court offered an extensive analysis of the leases entered into by No. 20, describing which leases constittued defalcations not dischargeable under § 523(a)(4).[4] If this court reverses the bankruptcy court, as it should, then the determination of the bankruptcy court that these leases constituted defalcations is controlling, because these findings have not challenged by Bennett. The question at this point is, however, whether the bankruptcy court should have addressed the measure of damages issue at all. For the following reasons, the bankruptcy court incorrectly concluded that Appellants (Plaintiffs below) were entitled only to recover actual damages and not full restitution.

A. *Equitable Restitution Is the Appropriate Remedy*

The bankruptcy court was troubled with the possibility that full restitution should be awarded under Texas law "regardless of whether the defalcation was for $10.00 or for $10 million." Initially, it should be noted that this

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[4] It should be noted that the mere fact that equipment necessary to open and operate the hotel was not provided by Bennett is a defalcation. The equipment that was leased could have been brought. (Tr. 51-52, 70-71, 159-63, 314-315, 320-21; Ex. 36). By not buying the equipment, a distribution of $1,000,000 was available and made to Bennett. (Memorandum Opinion at 6). Bennett did not pay the rental expenses; rather, they were paid by the partnership. Total rental expense was $887,000 (Ex. 36-40). The court found $832,204 as being the subject of a defalcation. (Memorandum Opinion at 31).

concern is not one which the bankruptcy court or this court need address since more than $10.00 was defalcated. In fact, the bankruptcy court acknowledged that over $900,000 was defalcated. Moreover, this $900,000 does not include the $1,000,000 Bennett defalcated when he distributed that amount to himself upon the opening of the hotel.

The bankruptcy court also found that despite the existence of controlling authority, *Crenshaw v. Swenson* and *Watson v. Limited Partners of WCKT, Ltd.*, it would not award full restitution as damages to the limited partners of M/G. The court noted:

> The damage issue is straightforward and would not be complicated if it were not for the seminal case of *Watson* . . . . There, the Austin Court of Appeals, in awarding restitution, held that it was not necessary that there be proximate cause between the breach and the damages awarded because the fiduciary breached his duties, and, thus, the limited partners were entitled to restitution of their entire investment as a matter of law. [citations omitted] In *Crenshaw, supra* at 891, the court stated, "courts are ill-equipped to discern the extent a conflict of interest *may* have affected the outcome of any given transaction . . . .
>
> The cases cited in *Watson* only held that, if a fiduciary breaches his duties, he forfeits his *right to compensation* as a matter of law, without regard to whether there is proximate cause between the breach and the damages. Those cases do not hold that the injured beneficiaries of the fiduciary relationship are entitled to *restitution of their entire investment,* without regard to proximate cause.

(Memorandum Opinion at 36-37 (emphasis in original)).

Both the reasoning and conclusion of the bankruptcy court are flawed. First, the bankruptcy court's decision in

this case is directly contrary to the settled rulings in *Crenshaw* and in *Watson*. The bankruptcy court is only supposed to apply Texas law, not decide what it should be. *Cf. Butner v. U.S.*, 440 U.S. 48 (1979).

Second, the bankruptcy court's strained construction of the opinion in *Watson* ignores the holding of the court there. The *Watson* court relied on prior Texas Supreme Court precedent: *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942).

> It is beside the point for either Turner or Corbett to say that Kinzbach suffered no damages because it received full value for what it has paid and agreed to pay. A fiduciary cannot say to the one whom he bears such relationship: You have sustained no loss by my misconduct in receiving a commission from a party opposite to you, and therefore you are without remedy. *It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired.* It is the law that in such instances if the fiduciary takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principal, without a full disclosure, it is a betrayal of his trust and a breach of confidence, *and he must account to his principal for all he has received.*

Kinzbach, 160 S.W. at 514 (emphasis added; citations omitted).

The bankruptcy court noted that in some instances a fiduciary must forfeit his right to compensation. *Citing Kinzbach Tool, supra; Anderson v. Griffith*, 501 S.W.2d 695 (Tex. Civ. App.—Fort Worth 1973, writ ref'd n.r.e.) and *Russell v. Truitt*, 5321 S.W.2d 948 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.). The court noted that those cases "do not hold that injured beneficiaries of the

fiduciary relationship are entitled to restitution of their entire investment. . . . Opinion at 36-37. This should come as no surprise. The cases cited did not involve investments or the misuse of trust funds held by a trustee. They all involved commissions wrongfully obtained by agents. The agents had to account for all that they received. So does Bennett.

The facts found by the court below demonstrates clearly that in this case there was a defalcation by a fiduciary through acts of self dealing. There is no requirement of proximate cause. Beneficiaries of a trust may attack self dealing transactions by a trustee even if they suffer no damages and even if the trustee acts in good faith. *Slay v. Burnett Trust,* 143 Tex. 621, 187 S.W.2d 377, 389 (1945); *Harvey v. Casbeer,* 531 S.W.2d 206 (Tex. Civ. App.—Tyler 1975, no writ). Upon a finding of breach, the trustee must account for all he has received. *Watson, supra,* 570 S.W.2d at 182.

In *Watson,* the court held that restitution was a recognized measure of recovery and that a showing of proximate cause of actual loss was not required. 570 S.W.2d at 182; *Russell v. Truitt,* 554 S.W.2d 948 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.). The court noted that suits such as this are to recover money had and received, and the money received by the general partner as contributions by the limited partners were due as restitution. *Id.*

The bankruptcy court chose to ignore *Crenshaw v. Swenson, supra,* because it cited *Watson* for a different proposition. Memorandum Opinion at 37 n.2. However, the court in *Crenshaw* clearly held that no damages need be shown and that, upon a showing of a breach of fiduciary duty, the limited partners were entitled to equitable restitution of their partnership contribution. *Id.* 611 S.W.2d at 891. It should be noted again that Swenson was the general partner of the general partner of the limited partnership.

Third, the bankruptcy court's notation that "[a] plaintiff must introduce sufficient evidence to provide a trier of fact with an intelligent means in determining an appropiate damage award without speculation or conjecture," Memorandum Opinion at 38, is an argument which favors *Appellants*, not Bennett. Speculation or conjecture is far greater with respect to damages when a court reviews several leases and engages in a complicated analysis of actual damages, instead of simply awarding full restitution to the wronged parties. In this case, the parties stipulated the amounts of Appellants' investments in the partnership. (*See* Stipulation filed August 23, 1989, at *Appendix A*). The contribution by the limited partners are certain and easier to quantify when compared to an analysis of which leases were proper and which were not. The bankruptcy court should not have subsituted its decision in the face of such overwhelming Texas law to the contrary.

B. *The Proceeding Involved Only the Dischargeability of Bennett's Debt*

The bankruptcy court, in calculating actual damages, assumed its proper role was *sua sponte* to calculate damages upon the determination that a debt was nondischargeable. This practice of calculating damages, however, was rendered obsolete when the Bankruptcy Code was enacted in 1978. Section 17c(3) of the old Bankruptcy Act provided that if a debt were found to be nondischargeable, the bankruptcy court was to "determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof." This language was omitted from Section 523 of the Bankruptcy Code, the successor statute to Section 17c(3) of the old Bankruptcy Act. Now the proper procedure for determining claims is the claims objection procedure, found at 11 U.S.C. § 502 and Bankruptcy Rules 3001, *et seq.* Depending upon the context of the claims procedure, an

objection to claim will either be a contested matter or an adversary proceeding pursuant Bankruptcy Rules 7001 *et seq.* and 9014. *Section 523 is silent as to the liquidation of nondischargeable debts.*

The few courts which have adhered to the procedure provided under the old Bankruptcy Act cite as their authority the provisions and cases under the old Bankruptcy Act. *See In re Lorren*, 45 B.R. 584, 589 (Bankr. N.D. Ala. 1984); *In re Cope*, 35 B.R. 287, 288 (Bankr. W.D. Mich. 1983). These cases, however, are incorrect under the present Bankruptcy Code's operation.

A number of courts which have interpreted this question under the Bankruptcy Code have ruled precisely as Appellants in this case contend. The bankruptcy court in *In re Stelweck*, 86 B.R. 833, 844-45 (Bankr. E.D. Pa. 1988), *aff'd*, 108 B.R. 488 (E.D. Pa. 1989), stated:

> We disagree with the assertion that liquidation of a debt has any bearing on whether it is dischargeable or not. The role of the bankruptcy court is not to determine the extent of non-dischargeable debts . . . but to determine whether debts are dischargeable. . . .
>
> We acknowledge that Section 17c(3) of the predecessor Bankruptcy Act provided that "if any debt is determined to be non-dischargeable, [the court] shall determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof." However, without any apparent explanation in the legislative history, this provision was omitted from § 523 of the Bankruptcy Code. We are most reluctant to read such an omitted provision back into the Code.

Id. at 844.

Other courts have ruled in the same manner as did the court in *Steiweck*. *See In re Crist*, 85 B.R. 807, 816 (Bankr. N.D. Iowa 1988):

> Finally, the Court herein makes no determination of the actual amount of taxes that are non-dischargeable. [The] IRS has urged the Court to accept the amount stated in the Notice of Deficiencies . . . . Any presumption that the amounts in the Notices of Deficiencies are correct. . . or any presumption arising under Bankr. R. 3001(b) are therefore, more appropriately recognized by the Court in a subsequent adversary proceeding, if necessary, in which the validity of [the] IRS' claim is adjudicated.

In re Lambert, 59 B.R. 503, 507 (Bankr. M.D. Ala. 1986):

> As to the court's erring and failing to set damages to this case, we conclude that it is not incumbent on the court in every instance to assess the amount of the debt which is determined to be non-dischargeable. That matter is already an issue, and the only matter before the court is the dischargeability of the debt, a matter exclusively within the jurisdiction of this court, then it is appropriate to leave the liquidation of damages to another court.

It follows then that the proper interpretation of the interaction between adversary proceedings challenging the dischargeability of debts and adversary proceedings challenging the amount of claims against the debtor is not as the bankruptcy court assumed it is. Under the Bankruptcy Code, when a finding of non-dischargeability is made, the creditor can either liquidate the amount of the debt in the bankruptcy court under 11 U.S.C. § 502 and the applicable bankruptcy rules, or it can do so in state court. By filing a proof of claim, the creditor will receive what it can from the bankruptcy estate, with the balance owing and payable from the debtor's post-discharge earn-

ings. If a proof of claim is not filed, however, the creditor can seek only post-discharge earnings; it forfeits the right to the participation of funds from the bankruptcy estate.

In this case, Appellants, in fact, did file proofs of claim. To date, no party has challenged these proofs of claim. Thus, there should have been no controversy regarding the amounts asserted by Appellants with respect to damages in this case. If a controversy existed, Bennett or the trustee should have filed the appropriate adversary proceeding. The issue should not have been raised by the bankruptcy court at this time.

Moreover, the exhibits by both parties in this case were directed only to the question of the dischargeability of Bennett's debt, not the amount of damages. In fact, Appellants (Plaintiffs below) operated under the assumption throughout this case that the question of damages was not at issue, since that question would have been determined under 11 U.S.C. § 502 and Bankruptcy R. 3001 *et seq.*

Indeed, the amount of damages at stake was being disputed in a state court action brought by the plaintiffs against Bennett prior to the institution of Bennett's bankruptcy case. The bankruptcy court denied plaintiff's motion to consolidate the state court case with the adversary proceeding to challenge the dischargeability of Bennett's debt to the plaintiffs. By denying this motion to consolidate, and by determining damage issues without notice or any basis under the Bankruptcy Code, the bankruptcy court effectively denied the limited partners of M/G an opportunity to offer their affirmative evidence of damages. The bankruptcy court ruled on damages without evidence available from the state court action, and without having the appropriate evidence presented in adversary proceeding. For these reasons, this court should, at the very least, remand the matter back to the bankruptcy court for a proper determination of damages.

CONCLUSION

For all of the reasons specified above, Appellants respectfully request that this court reverse the February 20, 1990 Memorandum Opinion and Final Judgment of the bankruptcy court in all respects.

Respectfully submitted,

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE MCLEMORE,

Plaintiffs-Appellants,

VS.

ARCHIE BENNETT, JR.,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

APPELLANTS' MOTION TO CLARIFY JUDGMENT

TO THE HONORABLE COURT OF APPEALS:

In ruling on Bennett's second petition for rehearing, this Court modified its judgment to limit Appellants' recovery to their partnership interests. The modified judgment, however, does not contain an instruction concern-

ing interest. According to Fed. R. App. P. 37, "[i]f a judgment is modified or reversed with a direction that a judgment for money be entered in the district court, the mandate shall contain instructions with respect to the allowance of interest." Because Appellants are entitled to interest as a matter of law, Appellants respectfully request that this Court clarify its judgment to instruct the district court to include the appropriate pre- and postjudgment interest. *See Cavnar v. Quality Control Parking*, 696 S.W.2d 549, 554 (Tex. 1985) ("as a matter of law, a prevailing plaintiff may recover prejudgment interest"); *Fuchs v. Lifetime Doors, Inc.*, 939 F.2d 1275, 1280 (5th Cir. 1991) (*Cavnar* "must be read to create a judicial scheme for the award of prejudgment interest in all cases") (quoting *Crown Cent. Petroleum Corp. v. National Union Fire Ins. Co.*, 768 F.2d 632, 637 (5th Cir. 1985)).

Appellants preserved their right to prejudgment interest by consistently requesting prejudgment interest in their pleadings in the bankruptcy and the district court. *See* Complaint at ¶ 19, 20, 21. Because the trial court denied relief on the merits and consequently did not consider the question of prejudgment interest in its opinion or in its judgment, Appellants did not treat prejudgment interest as an issue on appeal. Appellants, however, should not lose their right to prejudgment interest simply because the district court reached the wrong result. *See e.g., Phillips Petroleum Co. v. Oldland*, 187 F.2d 780, 782 (10th Cir. 1951), *cert. denied*, 342 U.S. 816 (1951) (question of prejudgment interest was open in case in which trial court denied relief on the merits and therefore did not address the question of interest).

Unless this Court includes an instruction on interest, the district court will not have authority to enter such an award. *See e.g., In re Incident Aboard the D/B Ocean King*, 877 F.2d 322, 324 (5th Cir. 1989) (recalling and reforming the mandate in order to provide for the re-

covery of interest). In the interests of justice, therefore, and as required by Fed. R. App. P. 37, Appellants respectfully request that this Court clarify its judgment and instruct the district court to include the appropriate pre- and postjudgment interest.

DATED this 21st day of July 1993.

Respectfully submitted,

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE MCLEMORE,

Plaintiffs-Appellants,

VS.

ARCHIE BENNETT, JR.,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

APPELLANTS' REPLY TO BENNETT'S RESPONSE CONCERNING CALCULATION OF DAMAGES

TO THE HONORABLE COURT OF APPEALS:

Appellants respectfully request the opportunity to respond to Archie Bennett Jr.'s ("Bennett's") latest out-of-time motion. According to Bennett, this Court should

address his contentions concerning a double recovery. All issues pertaining to Bennett's defalcations, however, have been briefed to this Court and this Court has ruled adversely to Bennett. Slip op. at 27.

As Bennett observes, this Court previously requested Appellants to "address appellee's contention that the panel erred in the calculation of damages (in reference to the figure 28.4% of the total)." Letter from Susan Vaughn, Case Manager, dated June 11, 1993. That issue had not briefed or addressed in this Court's opinion because Appellants had not previously received judgment in their favor. Indeed, Appellants consistently requested restitution and had not specifically addressed the bankruptcy court's hypothetical damage calculations.

This Court, however, did address Bennett's defalcations in its opinion. Slip op. at 26-27. This Court agreed with the findings of the bankruptcy court that Bennett improperly charged the partnership for "$72,000 worth of repair on the HVAC system and $832,204.40 worth of equipment leases." *Id.* at 26. In addition, this Court recognized that "[u]nder Texas law, a fiduciary who breaches his duties forfeits his rights to compensation as a matter of law. *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942); *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 318 (Tex. App.—Tyler 1985, no writ); *Anderson v. Griffith*, 501 S.W.2d 695, 702 (Tex.Civ.App.—Forth Worth 1973, writ ref'd n.r.e.)." *Id.* at 27. Bennett, therefore, committed "an act of self dealing and a breach of the duty of good faith and fair dealing" when he "paid himself the $1 million distribution when at the same time he improperly charged more than $800,000 in equipment leases to the limited partners." *Id.* As this Court recognized, Bennett was not entitled to compensation while "willfully neglect[ing] his duties to the limited partners," *id.*, and he was not entitled to the $1 million distribution even if, as

Bennett asserts, the hotel was completed at a cost of $21 million.

Indeed, there is simply no "double counting" in the Court's award of damages. Bennett stole $1 million from his partners when the hotel opened in January 1981. He then proceeded to steal another $904,204.40. The facts on this point were never in dispute: Bennett got the $1 million and never paid the $904,204.40. Thus the partners were damaged in that amount.

Bennett also contends that Appellants waived their right to prejudgment interest. Significantly, Bennett does not dispute that Appellants are entitled to prejudgment interest. Bennett makes only the assertion, frivolous under the circumstances, that Appellants waived their right to such interest.

Contrary to Bennett's assertions, Appellants adequately preserved their right to prejudgment interest by consistently requesting prejudgment interest in their pleadings in the bankruptcy and the district court. According, to Bennett, however, Appellants had to appeal from the district court's failure to award prejudgment interest. The district court, however, never entered an a judgment from which Appellants could appeal its failure to award prejudgment interest. *See e.g.*, Fed. R. App. P. 3(c) (requiring a party to "designate the judgment, order or part thereof appealed from"). Appellants simply were not obliged to appeal from a hypothetical judgment never entered in their favor.

Conclusion and Prayer for Relief

This appeal must have an end. The parties have briefed the issues, and this Court has issued its ruling. At most, this Court need modify its mandate to instruct the district court to enter judgment consistent with the Court's opinion, along with pre-and post-judgment interest and costs, according to Appellants' respective partnership interests.

Appellants, therefore, respectfully request that this Court deny Appellee's various motions and issue its mandate.

DATED this 22 day of June 1993.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF: ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE MCLEMORE,

Appellants,

versus

ARCHIE BENNETT, JR.,

Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

ARCHIE BENNETT'S MOTION FOR LEAVE TO FILE REPLY AND REPLY TO APPELLANTS' RESPONSE CONCERNING CALCULATION OF DAMAGES

[Filed June 21, 1993]

TO THE HONORABLE JUSTICES OF THE FIFTH CIRCUIT:

Archie Bennett, Jr. ("Mr. Bennett") files this Motion for Leave to File Reply and Reply to Appellants' Response Concerning Calculation of Damages (the "Reply"), and respectfully states as follows:

A. Introductory statement

1. The Court directed that the Appellants file a response to Mr. Bennett's Second Petition for Rehearing concerning the calculation of damages in this case. The Appellants did so (the "Response") on June 16, 1993 and have conceded Mr. Bennett was right all along: at best they only get 28% of the total damages suffered by the parnership. However, the Response fails to address (or concede) the second obvious issue (the double recovery) and now raises a heretofore new issue, thus compounding further the extraordinary procedural history that has plagued this appeal. After admitting the correctness of Mr. Bennett's damages calculation, the LSP Parties have now asked the Court to *sua sponte* compute prejudgment interest on this Court's final assessment of damages even though the Appellants *never* raised the issue of prejudgment interest (i) during the bankruptcy court trial (Record at pp. 1 to 554); (ii) the district court appeal; or (iii) in their original brief or petition for rehearing filed with the Court. Under established Fifth Circuit law, Appellants have therefore waived the issue of prejudgment interest for this Court's consideration. For these reasons, cause exists to grant leave of Court to allow Mr. Bennett to file this Reply to further assist the Court in ensuring a proper result.

B. APPELLANTS HAVE WAIVED THEIR ENTITLEMENT TO PREJUDGMENT INTEREST BECAUSE APPELLANTS NEVER TIMELY RAISED THIS ISSUE IN THEIR BRIEF ON APPEAL.

2. FRAP 28(a) designates what must be contained in a brief prepared by an appellant. This rule has been uniformly construed by appellate courts to mandate that the brief of an appellant contain *all* issues presented for review. *See* 16 C. Wright, A. Miller, E. Cooper & E. Gressman, *Federal Practice and Procedure* § 3974, at 421 (1977). As a consequence, it has been stated by this Court on numerous occasions that issues "not raised or argued in the brief of the appellant may be considered waived and thus will not be noticed or entertained by the court of appeals." *Texas Mortgage Servs. Corp. v. Guadalupe Sav. & Loan Ass. (In re Texas Mortgage Servs. Corp.)*, 761 F.2d 1068, 1073 (5th Cir. 1985) ("Without reaching the merits of appellant's argument, we find that this issue has been waived."), *citing, Cannon v. Teamsters & Chauffers Union*, 657 F.2d 173, 177-78 (7th Cir. 1981) ("it would be patently unfair for the court to consider the new issue as properly before it since the other side had not been given advance warning that the issue would be raised.")[1]

3. Before this latest (and hopefully last) stage of the appellate process, no mention of prejudgment interest has previously been made by Appellants since this appeal was initiated. Aside from Appellants' Complaint filed with the bankruptcy court (*see* Complaint at ¶¶ 19-21), Appellants' entitlement to prejudgment interest was never

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[1] *See also United Paperworkers Int'l Union v. Champion Int'l*, 908 F.2d 1252, 1255 (5th Cir. 1990) ("an appellant abandons all issues not raised in its *initial* brief."); *Travelers Indem. Co. v. Atlantic Express Line*, 837 F.2d 187, 188 (5th Cir. 1988) (Here, this even included a refusal to address an asserted due process claim raised at trial, where party "did not get to it during trial" or raise it in its brief.)

raised (i) during trial[2] (*see* Transcript of Hearing to Determine Dischargeability before Honorable Robert C. McGuire); (ii) in Appellants' brief on appeal to the district court (*see* Brief of Appellants to United States District Court); or (iii) in its brief to this Court (*see* Brief of Appellants to United States Coprt of Appeals for the Fifth Circuit). The bankruptcy court's damage calculation and judgment did not award Appellants interest. Appellants accepted this calculation, and never sought by argument, post trial motion or cross appeal to have it recognized either by the bankruptcy court or on appeal. Factually and legally, Appellants have accepted as final the bankruptcy court's damages calculation for which the appellate courts could adopt if they took a different view of the law (which the Court belatedly did by the Second Opinion). On this record, Appellants have thus not preserved any right to contend they are entitled to prejudgment interest by failing to properly present the issue on appeal to the district court and then to this Court in accordance with Rule 28(a) of the Federal Rules of Appellate Procedure.

4. This Court approved and adopted the method proposed by the bankruptcy court as to *actual* damages such that if Mr. Bennett's otherwise dischargeable lack of fiduciary responsibility was reversed on appeal, the amount of damages determined to be nondischargeable under section 523(a)(4) would be $904,204.40 as to the *entire* MG limited partnership, of which the Appellants, consisting of 28.4375% of MG, would take *only* their respective partnership ownership percentage multiplied by the defalcation found. *See* Memorandum Opinion of the bankruptcy court at p. 39. By this Court's adoption and affirmation of this reasoning and Appellants acceptance of the percentage calculation, Appellants are

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[2] As in *Travelers Indem. Co., supra,* they apparently just "didn't get to it during trial."

entitled to $257,133.13. Notwithstanding the Appellants' newly discovered candor in accepting the 28.4375% limitation as correct, Appellants continue to press the Court to *render* much higher damages inconsistent with established Fifth Circuit law and this Court's affirmation of the bankruptcy court's method of calculating damages. Appellants first seek to maintain (by not addressing) a windfall double recovery and second, attempt to compound the injustice with a claim for interest they never presented at trial, much less preserved on appeal. The LSP Parties should get at best the benefit found by the bankruptcy court and adopted by this Court: 28.4375% of $904,204.40 and no more on this record.

5. Appellants cite *Cavnar v. Quality Control Parking*, 696 S.W.2d 549, 554 (Tex. 1985) and its progeny as authority supporting Appellants' contention that they are entitled to prejudgment interest. *Cavnar* and its progeny, however, have never stood for the proposition that an appellant is entitled to prejudgment interest when that issue has not been properly brought on appeal. Rather *Cavnar*, and its progeny only address how to compute prejudgment interest when prejudgment interest is requested and awarded at the trial level. *Cavnar*, 696 S.W.2d at 554. This is simply not the case here.

6. Mr. Bennett earnestly believes that the issue of damages is only further clouded by the Appellants' contention at this stage of the appellate process. Respectfully, this Court must consider the manifest injustice and harsh result that will result to Mr. Bennett *for the rest of his life* and to anyone else ever similarly situated if the Court entertains consideration of prejudgment interest at this late juncture and does not reconsider and correct its ruling on damages which can *never* be discharged. Mr. Bennett therefore respectfully petitions the Court to consider its decision on the amount of damages and refuse, as a matter of law, to consider prejudgment interest or remand the case because the damages awarded by this

panel are excessive, inconsistent with the record in this case, absolutely contrary with the Court's affirmation of the bankruptcy court's fact finding on this point, and simply exceed that permitted by applicable law.

C. MOTION FOR LEAVE TO FILE SECOND PETITION FOR REHEARING

7. On this extraordinary procedural record in a case that has produced extraordinarily harsh and far reaching results, Mr. Bennett respectfully requests leave of Court to file his Reply. Because of the substantial effect an award of prejudgment interest would have on Mr. Bennett and the impact of the Court's decision reversing and rendering the panel's prior decision thereby making Mr. Bennett liable for 100% of $1.9 million in damages (which the Response's only now admits was incorrect at least insofar as the percentage damage calculation), Mr. Bennett respectfully urges the Court to allow one last opportunity to correct what may well be a mistake based upon the undisputed record in this case.

8. Cause exists to authorize the relief permitting Mr. Bennett to file this Reply. The LSP Parties, who only now on direction from the Court agreed the Court's award of $1.9 million is subject to their 28.4375% interest in the entire partnership interest and not 100% of the damages, have now in contravention of established Fifth Circuit law attempted to further cloud the issue of damages for the Court's consideration by asking for prejudgment interest. Moreover, these same Appellants continue to implicitly rely on the Court's erroneous total damages award suffered by the partnership of $1.9 million.[3] This tardy claim unjustly attempts to enrich the

[3] While not wanting to unnecessarily belabor the point, but given its devastating impact, Mr. Bennett believes that the LSP Parties should also be directed to respond to his contention that the $1.9 million is a double recovery. Perhaps candor will again bring forth the admission that this part of the Court's opinion is

Appellants for prejudgement interest which Appellants have not preserved as a matter of law.

WHEREFORE, Mr. Bennett prays the Court authorize the filing of his Reply and grant such other and further relief as is just, proper and equitable.

Respectfully submitted this 21st day of June, 1993.

VERNER, LIIPFERT, BERNHARD,
MCPHERSON AND HAND,
CHARTERED

/s/ Patrick L. Hughes
LENARD M. PARKINS
PATRICK L. HUGHES
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Attorneys for Archie Bennett, Jr.

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incorrect, comprising a double recovery, given that whether or not Bennett put in via Mariner Interests No. 20 ("MI 20") the additional $904,200.40 to purchase the items found to be a defalcation, MI 20 still under either circumstance would have benefitted to the extent of the $1 million because that is what the underlying agreement called for. The record reflects MI 20 was entitled to receive the benefit of any construction savings if the hotel was built for less than $22 million. *See* Partnership Agreement, Article 2, Section 2.1(a)(6) at p. 5. Before taking into account the $904,200.40, the hotel cost $21 million. Whether or not MI 20 put in the $904,000 before taking the $1 million or left the $1 million in to purchase the items complained of, the only loss to the partnership (and benefit to MI 20) was the $1 million taken.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE MCLEMORE,
Plaintiffs-Appellants,

vs.

ARCHIE BENNETT, JR.,
Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

APPELLANTS' RESPONSE CONCERNING
CALCULATIONS OF DAMAGES

TO THE HONORABLE COURT OF APPEALS:

This Court has requested Appellants' views concerning the proper calculation of damages. Appellants agree with the bankruptcy court that the most accurate assessment of damages would multiply the amount of Bennett's defalcation, or $1,904,204.40, by Appellants' respective partnership interests. (*See Memorandum Opinion of*

Bankruptcy Court at p.39.) However, LSP *et al.* are entitled to prejudgment interest on such amounts at 10% compounded daily. *See Cavnar v. Quality Control Parking*, 696 S.W.2d 549, 554 (Tex. 1985) ("We therefore hold, as a matter of law, a prevailing plaintiff may recover prejudgment interest compounded daily (based on a 365-day year) on damages that have accrued by the time of judgment)); *Spangler v. Jones*, —— S.W.2d ——, 1993 WL 174276, slip op. at 6 (Tex. App. —— Dallas May 25, 1993) (en banc) (prejudgment interest should compounded daily in cases not involving wrongful death, personal injury, or condemnation); *Davis v. Twin City Fire Ins. Co.*, —— S.W.2d ——, 1993 WL 199357, slip op. at 6 (Tex. App. —— Texarkana June 15, 1993) ("if all the plaintiff's damages accrue at an ascertainable amount on the date of the injury, then prejudgment interest is calculated from that date"); *Fuchs v. Lifetime Doors, Inc.*, 939 F.2d 1275, 1280 (5th Cir. 1991) (*Cavnar* "must be read to create a judicial scheme for the award of prejudgment interest in all cases") (quoting *Crown Cent. Petroleum Corp. v. National Union Fire Ins. Co.*, 768 F.2d 632, 637 (5th Cir. 1985)).

This Court has awarded prejudgment interest at 10% compounded daily where *Cavnar* is applicable. *Law Offices of Moore & Associates v. AETNA Insurance Co.*, 902 F.2d 418, 422 (5th Cir. 1990); *Ensearch Corporation v. Shand Monahan & Co., Inc.*, 952 F.2d 1485, 1499 (5th Cir. 1992). Here, the claims of LSP *et al.* arise under state law as claims for breach of fiduciary duty. LSP *et al.* requested prejudgment interest in both the complaint and its original state court suit against Mr. Bennett. (*See* Complaint at ¶ 19, 20, 21.) As a result, prejudgment interest should be awarded at the rate of 10% compounded daily.

The date for calculating prejudgment interest on the $1,000,000 distribution that Bennett appropriated to himself is January 1981. The remaining balance of

$904,204.40 was taken at various points in time. For ease of calculation, Appellants' suggest using the date that they filed their original lawsuit against Mr. Bennett for calculating pre-judgment interest on the $904,204.40. That date is November 21, 1984. Using these dates, the amount of prejudgment interest is $3,578,370.43.

The total amount, therefore, to be multiplied by each Parties' partnership interest and the judgment, including prejudgment interest through the date of this Court's judgment (April 19, 1993), that should be entered in favor of each of the LSP Parties is $5,482,571.83 multiplied by their partnership interest:

Partner	%	Judgment
LSP Investment Partnership	1.75	$ 95,945.00
Charles Sapp	4.4375	243,289.12
Howard Boyd	0.625	34,266.07
R. Bruce LaBoon	1.25	68,532.15
Thomas Reidy	6.25	342,660.74
H. Michael Tyson	0.50	27,412.86
John C. Nabors	0.625	34,266.07
George Carameros	0.9375	51,399.11
Willis Witt	0.50	27,412.86
Walter P. Zivley	1.25	68,532.15
Fred E. Croshaw (as agent for Croshaw Investment Partnership)	1.25	68,532.15
W. Robert Brown	2.5	137,064.30
Frank A. Liddell, Jr. (as agent for Obie & Co.)	3.75	205,596.44
Carl Galloway	0.625	34,266.07
Don C. Quast	0.9375	51,399.11
Joe E. McLemore	1.25	68,532.15
TOTAL	28.4375	1,559,106.35

Further, the judgment should include post judgment interest at the rate provided in 28 U.S.C. § 1961. *See* F.R.App.P. 37.

Appellants respectfully request that this court render judgment in favor of Appellants for the amounts calculated above, plus post-judgment interest until judgment is collected at the maximum rate permitted by law.

DATED this 15 day of June 1993.

Respectfully submitted,

By /s/ D. Mitchell McFarland
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UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT
OFFICE OF THE CLERK

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June 11, 1993

Mr. D. Mitchell McFarland
Attorney at Law
3300 Texas Commerce Tower
Houston, TX 77002

No. 91-1059

LSP Investment Partnerships, Et al. v.
Archie Bennett, Jr.

Dear Sir:

This is to confirm our telephone request of this date wherein we advised that the Court has requested that you file a response to the motion of appellee for leave to file second suggestion for rehearing en banc. The Court request that you address appellee's contention that the panel erred in the calculation of damages (in reference to the figure 28.4% of the total). The response is due to be filed in this office by no later than June 18, 1993.

Should you have any questions concerning the above, please feel free to contact this office.

Very truly yours,

RICHARD E. WINDHORST, JR.
Clerk

By /s/ Susan Vaughn
SUSAN VAUGHN
Case Manager

SV RF:lmc
cc: Mr. Lenard M. Parkins

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

IN THE MATTER OF: ARCHIE BENNETT, JR.,
Debtor.

LSP INVESTMENT PARTNERSHIP, *et al.*,
Appellants,

versus

ARCHIE BENNETT, JR.,
Appellee.

Appeal from the United States District Court
for the Northern District of Texas

ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(May 21, 1993)

Before POLITZ, Chief Judge and HIGGINBOTHAM, Circuit Judges, and PRADO,* District Judge.

PER CURIAM:

(√) The Petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Pro-

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* District Judge of the Western District of Texas, sitting by designation.

cedure and Local Rule 35) the Suggestion for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Henry A. Politz
HENRY A. POLITZ
United States Chief Judge

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE,

Plaintiffs-Appellants,

VS.

ARCHIE BENNETT, JR.,
Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

BRIEF FOR APPELLANTS

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certify that the following listed persons have an interest in the outcome

of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

1. LSP Investment Partnership, a Texas Partnership
2. Charles Sapp
3. Howard Boyd
4. R. Bruce LaBoon
5. Thomas Reidy
6. H. Michael Tyson
7. John C. Nabors
8. George Carameros
9. Willis Witt
10. Walter P. Zivley
11. Croshaw Investment Partnership (by its agent, Fred E. Croshaw)
12. W. Robert Brown
13. Obie & Co. (by its agent, Frank A. Liddell, Jr.)
14. Carl Galloway
15. Don C. Quast
16. Joe E. McLemore
17. Liddell, Sapp, Zivley, Hill & LaBoon, by and through D. Mitchell McFarland, Cynthia L. Osborn, and Paul L. Alpern (Counsel for the Plaintiffs-Appellants).
18. Sheinfeld, Maley & Kay, by and through T. Glover Roberts, Lenard M. Parkins, Jane Pearson Hirst, and Madelyn Choi (Counsel for the Defendant-Appellee).
19. Archie Bennett, Jr.

/s/ D. Mitchell McFarland
D. MITCHELL MCFARLAND
Attorney for Plaintiffs-Appellants

STATEMENT REGARDING ORAL ARGUMENT

Appellants request oral argument in this bankruptcy appeal pursuant to Fed.R.App.P. 34. This Court will be significantly aided by oral argument, which will demonstrate that the Bankruptcy Court and District Court seriously misinterpreted important principles of bankruptcy law and Texas partnership law, depriving Appellants of their ability to pursue claims worth over $3 million against the Debtor, Archie Bennett, Jr. The District Court below noted that the question presented by this case is one where this Court has yet to rule (Slip Op. at 3). Oral argument would assist this Court in understanding the facts and law which show that Bennett is not entitled to a discharge.

Bennett has been allowed to discharge debts that the Bankruptcy Court found to arise at least in part from defalcations made by Bennett and a limited partnership under his control. Only honest but unfortunate debtors are entitled to discharge their debts in bankruptcy—a principle recently reaffirmed by the United States Supreme Court in *Grogan v. Garner*, 111 S. Ct. 654 (1991) (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)). Appellants request that they be heard on these important issues and principles.

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1059

LSP INVESTMENT PARTNERSHIP, A TEXAS PARTNERSHIP, CHARLES SAPP, HOWARD BOYD, R. BRUCE LABOON, THOMAS REIDY, H. MICHAEL TYSON, JOHN C. NABORS, GEORGE CARAMEROS, WILLIS WITT, WALTER P. ZIVLEY, CROSHAW INVESTMENT PARTNERSHIP (BY ITS AGENT, FRED E. CROSHAW), W. ROBERT BROWN, OBIE & CO., (BY ITS AGENT, FRANK A. LIDDELL, JR.), CARL GALLOWAY, DON C. QUAST, and JOE E. MCLEMORE,

Plaintiffs-Appellants,

VS.

ARCHIE BENNETT, JR.,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas, Dallas Division

STATEMENT OF JURISDICTION

The Court of Appeals has jurisdiction over this appeal pursuant to 28 U.S.C. § 1291, because it is an appeal from a final Memorandum Order and Judgment filed and entered by the United States District Court for the Northern District of Texas, Dallas Division, on December 14, 1990. The District Court affirmed the Memorandum

Opinion and Order filed and entered by the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, on January 20, 1990.

STATEMENT OF THE ISSUES

1. The District Court held that, under Texas law, the duty owed by a general partner to the limited partners in a limited partnership does not create a technical trust within the meaning of 11 U.S.C. § 523(a)(4). Was this error?

2. Archie Bennett, Jr. was the sole general partner of a limited partnership (Mariner Interest No. 20, Ltd.) which, in turn, was the sole general partner of the limited partnership in question (Mariner/Greenspoint, Ltd.) in which the Appellants were limited partners. The District and Bankruptcy Courts held that, under Texas law, Bennett, the only general partner, was not a trustee of a technical trust within the meaning of 11 U.S.C. § 523(a)(4). Was this error?

3. The District Court did not address the Bankruptcy Court's alternative conclusion regarding the proper amount of damages, although Appellants raised those issues on appeal. Accordingly, several issues in the Bankruptcy Court's decision relating to damages, not addressed by the District Court, are being raised again on appeal to this panel. Those issues are, as follows:

    a. The Bankruptcy Court did not find a defalcation occurred when Bennett received a $1 million distribution upon the opening of the hotel (whose construction and operation was the purpose of the limited partnership), even though Bennett knew that the hotel had a substandard design in its HVAC system (negative pressure), and did not have, as required, all equipment necessary to open and operate a fully equipped hotel. Was the Bank-

ruptcy Court's failure to find that Bennett committed this defalcation error?

b. The Bankruptcy Court found that, in the event its findings would be reversed on appeal, Appellants were only entitled to actual damages under Texas law and not full restitution of their contributions to the limited partnership. Was this measure of damages erroneous?

c. The Bankruptcy Court determined that Appellants were entitled only to actual of damages, even though the Complaint to Determine Dischargeability of Debt sought restitution of the full debt, the proof of claim for the full amount of the debt filed by Appellants was uncontested, the prepetition state court lawsuit (to determine damages) had not been consolidated with this lawsuit, and Appellants were not given any notice of this determination prior to the entry of the Bankruptcy Court's Memorandum Opinion and Final Judgment. Was this error?

STATEMENT OF THE CASE

I. NATURE OF THE CASE

Appellee, Archie Bennett, Jr. is a debtor under Chapter 7 of the Bankruptcy Code. Appellants, LSP Investment Partnership, a Texas Partnership, Charles Sapp, Howard Boyd. R. Bruce LaBoon, Thomas Reidy, H. Michael Tyson, John C. Nabors, George Carameros, Willis Witt, Walter P. Zivley, Croshaw Investment Partnership (By its agent, Fred E. Croshaw), W. Robert Brown, Obie & Co., (By its agent, Frank A. Liddell, Jr.), Carl Galloway, Don C. Quast, and Joe E. McLemore (collectively known as "LSP Parties" or "Appellants"), appeal from the District Court's December 14, 1990 Memorandum Order and Final Judgment, which affirmed the Bankruptcy Court's judgment that Bennett's debt owed to LSP was dischargeable in bankruptcy.

II. COURSE OF PROCEEDINGS AND DISPOSITION IN COURTS BELOW

The LSP Parties constitute some of the limited partners who contributed over $3.2 million to Mariner Greenspoint Ltd. ("M G"), a Texas limited partnership, whose sole general partner, Mariner Interest No. 20 ("No. 20"), was also a Texas limited partnership. Bennett, the Debtor herein, was the sole general partner of No. 20. On November 23, 1988, Bennett filed for relief under Chapter 7 of the Bankruptcy Code, Case No. 388-37142-RCM-7, in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. On February 17, 1989, Appellants filed a Complaint to Determine Dischargeability of Debt, Adversary Proceeding No. 389-3110, in the Bankruptcy Court (Record ("R.") at 1).[1] The LSP Parties allege that Bennett was personally responsible for defalcations of money from M G, which are more fully described below. Both sides filed motions for summary judgment, which were denied orally by the Bankruptcy Court on December 11, 1989 (R. at Vol. 10, page 20). Trial was held on December 18-20, 1989 (R. at Vols. 7-9).

On February 20, 1990, the Bankruptcy Court issued a Memorandum Opinion and a Final Judgment granting Bennett a discharge with respect to the debts disputed by Appellants (R. at 241-81).[2] The Bankruptcy Court found

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[1] The LSP Parties filed suit against Bennett and No. 20 in the 234th Judicial District Court of Harris County, Texas, Cause No. 84-69448, alleging breach of partnership agreement, breach of fiduciary duty and negligence, on November 21, 1984. Bennett filed for bankruptcy at approximately the time that the state court case was set to be called for trial. On February 17, 1989, concurrently with the filing of the Complaint to Determine Dischargeability of Debt, the LSP Parties removed the state court suit and attempted to consolidate the two suits. The motion to consolidate was denied.

[2] The Bankruptcy Court also denied a motion for sanctions that was heard on December 20, 1989. This ruling was not appealed.

that No. 20 was a fiduciary within the meaning of 11 U.S.C. § 523(a)(4) and that it committed defalcations from M/G totalling over $904,204.40 (R. at 273), but held that only No. 20, and not Bennett personally, had such a fiduciary duty to the LSP Parties (R. at 261-62). The Bankruptcy Court also held that, if on appeal Bennett's debt were found to be nondischargeable, then, on remand, Appellants' damages (the amount of the debt deemed to be nondischargeable) would only be Bennett's actual defalcations as determined by the Bankruptcy Court, not full restitution of the LSP Parties' contribution to M/G (R. at 280-81). The LSP Parties had filed an uncontested proof of claim for the full amount of restitution, however. Accordingly, the LSP Parties' Complaint to Challenge Dischargeability of Debt was directed solely to whether Bennett's debt was dischargeable, not the measure of damages.

On appeal, the District Court affirmed the Bankruptcy Court (R. at 397-404), but for a very different reason. The District Court seemed to assume that Bennett, as a general partner of No. 20, *did* have a direct fiduciary duty to the LSP Parties (R. at 399). The District Court held, however, that Bennett was not a fiduciary to the LSP Parties within the limited definition of "fiduciary" in Section 523(a)(4) of the Bankruptcy Code. The District Court found it unnecessary to reach the Bankruptcy Court's rulings on damages in light of its holding (R. at 402). Appellant filed this appeal from the District Court's Memorandum Order and Judgment on January 9, 1991 (R. at 405).

III. STATEMENT OF THE FACTS

The Bankruptcy Court's findings of fact were set forth in its February 20, 1990 Memorandum Opinion.[3] The Court's findings of fact are primarily undisputed, and

[3] A copy of the District and Bankruptcy Court Opinions are found in Appellants' Record Excerpts.

neither party has appealed those findings, with the exception that LSP has appealed the Bankruptcy Court's failure to find that a $1 million distribution to Bennett was a defalcation.

The LSP Parties are some of the limited partners of Mariner/Greenspoint, Ltd. ("M/G"), a Texas limited partnership. The Debtor, Archie Bennett, Jr., was the sole general partner of Mariner Interest No. 20, Ltd. ("No. 20"), which in turn was the sole general and managing partner of M/G. The purpose of M/G was to construct and operate a Marriott hotel near the Greenspoint Mall in Houston, Texas (Bankruptcy Court Opinion at 2-3, R. at 244-45).

Under the M/G partnership agreement ("Partnership Agreement"), Bennett could not voluntarily withdraw as the general partner of No. 20. Bennett as the sole general partner of No. 20 was the only individual with the power or authority to direct the affairs of M/G. (Plaintiffs' Exhibit ("Ex.") 2 at Art. 10, pp. 36-37).[4]

The Bankruptcy Court found that the Partnership Agreement conferred upon No. 20 full, exclusive, and complete authority and discretion to manage, control and decide all matters affecting the purposes of the partnership, to take any action required to effectuate the purpose set forth in Article 1.6 of the agreement, and to exercise all rights and powers generally conferred or inferred by law with regard to such obligations (Bankruptcy Court Opinion at 3, R. at 245). No. 20 was required to act in good faith in the performance of the obligations of the agreement (*Id.*).

The LSP Parties contributed a total of $3,292,137.50 to M/G (Bankruptcy Court Opinion at 3, R. at 245), a figure that was stipulated by the parties to this litigation (R. at 285). The LSP Parties and other limited partners and third-party financiers loaned or contributed approxi-

[4] Plaintiffs' Exhibits are found at Vols. 10-11 of the Record.

mately $22 million to M G, which was available to Bennett. Under the Partnership Agreement, Bennett was to use these funds to pay all actual costs necessary to construct, equip, and furnish the hotel so that it could be opened as a "first-class hotel" (Bankruptcy Court Opinion at 4-5, R. 245-46). The Partnership Agreement did not define a "first-class hotel," but the Bankruptcy Court found that in the context of this case the term "meant a Marriott-type hotel" (Bankruptcy Court Opinion at 4, R. at 246).

Art. 2.1(a)(6) of the Partnership Agreement provided that if funds were necessary to construct and equip a first-class Marriott Hotel beyond the $22 million in loans and partnership contributions, Bennett was required to contribute such amounts. If the Marriott Hotel were completed under budget, however, Bennett was entitled to a distribution of up to $4 million. *Id.* at Art. 7.1.

The Bankruptcy Court found that Mariner Corporation ("Mariner"), which at all relevant times was 100% owned by Bennett personally, carried out the obligations of No. 20 and acted on Bennett's behalf (Bankruptcy Court Opinion at 4-5, R. at 246-47). Mariner's employees understood that if there were savings on the project, those savings went directly to Archie Bennett, Jr. (Tr. December 18, 1989 at 27-28, 87-88, Vol. 7 of Record).

The Bankruptcy Court made findings of fact at pages 2-9 of its Memorandum Opinion:

1. Plaintiffs are and were at all relevant times in question, limited partners in a partnership known as Mariner/Greenspoint, Ltd.

2. Mariner Interest No. 20, Ltd. is and was at all relevant times the general partner of Mariner/Greenspoint, Ltd.

3. Bennett is and was at all relevant times the general partner of Mariner Interest No. 20, Ltd.

4. Bennett is a debtor in the bankruptcy case 388-37142-RCM-7 filed on or about November 23, 1988.

5. The partnership constructed and owned a Marriott hotel located near Greenspoint Mall at 255 Northbelt East, Houston, Harris County, Texas.

6. The partnership agreement is attached to the complaint as Exhibit A.

7. Plaintiffs invested the sums described in Exhibit B to the complaint.

8. Under the terms of the agreement, the general partner was charged with management of the partnership and had full, exclusive, and complete authority and discretion to manage, control and make all decisions affecting the purposes of the partnership, to take any action required to effectuate the purpose set forth in Article 1.6 of the agreement, and to exercise all rights and powers generally conferred or inferred by law with regard to such obligations.

9. The general partner was required to act in good faith in the performance of the obligations of the agreement.

10. The general partner was obligated under Article 2.1(a)(6) of the agreement to contribute cash to the extent necessary to pay all of the actual costs incurred to construct, equip, and furnish the hotel in such manner that it could be opened and operated as a first-class hotel.

11. Bennett was made aware of mildew problems at the Brookhollow Marriott, similar to those which plagued the Greenspoint Marriott.

12. The heating, ventilation, and air conditioning design of the Brookhollow Marriott was substantially the same as the Greenspoint Marriott.

13. Mariner and Bennett attempted to rectify the mildew problem by rebuilding those rooms which were damaged by mildew, including the removal of all wall coverings, sheetrock, and fiberglass insulation and the reinstallation of such materials in an attempt to solve the problem.

14. Before taking any "savings" (Pl Ex. 2, ¶ 7.2, 2.1(a)(6)) allowed under the partnership agreement, the general partner was required to provide all equipment to operate the hotel as a "first-class hotel."

15. Mariner Corporation, at all times relevant to this action, was owned 100% by Archie Bennett, Jr. Mariner Corporation, its officers and employees, acted on behalf of Mariner Interest No. 20, Ltd. and Archie Bennett, Jr. in carrying out the obligations of the general partner of Mariner/Greenspoint, Ltd.

16. The Greenspoint Marriott Hotel opened in January 1981.

17. Prior to the opening, Mariner Corporation was concerned about its loan arrangement, which committed only until February 1981. If Mariner was unable to complete the construction and missed the opening, Mariner stood to lose an additional $1 million.

18. Eaves Construction Co., the general contractor ultimately awarded the construction contract for the Greenspoint Marriott Hotel, was one of the original bidders for the Greenspoint Marriott. All of the bids initially submitted to Mariner, including Eaves', were at least $1 million over the budget amount of $22 million.

19. Subsequently, after consultation with Mariner, Eaves dropped its bid price by $1 million and got the bid. However, Eaves was unable to obtain a bond. Bennett told Eaves it could have the job without a bond if it reduced its fee (the general contractor's fee) by one-half.

20. The general contractor's fee represents its profit on the job, assuming there are no construction savings.

21. Eaves was unable to obtain a bond because it had no prior history of constructing large projects and had no financial strength.

22. The reduction of the contractor's fee reduced the bid by an additional $250,000.

23. It was not normal to use a contractor that could not be bonded. Some Mariner personnel expressed concern to Bennett about Eaves' ability to run a business.

24. Mariner employees were aware that, if the project was completed under budget, the savings would be paid directly to Archie Bennett, Jr.

25. The hotel was built on a 'fast track" system. This system involved developing plans to a certain point, and having subcontractors bid on the specifications without the benefit of actual drawings. This type of system accelerates completion of the project. Marriott had to approve all plans developed under the "fast track" system.

26. In August 1980, Marriott reluctantly granted approval of the heating, ventilation and air conditioning design for the Greenspoint Marriott Hotel because of the advanced stage of the construction. However, Marriott anticipated that

the guest rooms would have a musty odor. Further, Marriott conditioned its approval upon Bennett accepting full responsibility for any reparations required by subsequent mildew damage. The design was not acceptable by Marriott design standards and would not be permitted in future hotels projects.

27. In late summer 1980, a mildew problem began to occur in the guest roms of the Brookhollow Marriott Hotel, which was designed the same as the Greenspoint Marriott. By November, mildew had occurred in 55 of 200 rooms checked at the Brookhollow Marriott.

28. At the time of the opening of the Greenspoint Marriott in January 1981, Archie Bennett, Jr., received a $1 million distribution. The $1 million was a result of constructing the Greenspoint Marriott Hotel for less than the budgeted $22 million.

29. Mildew began to occur in the guest rooms of the Greenspoint Marriott in April 1981. By July 1981, mildew had appeared in 169 of the 400 rooms at the Greenspoint Marriott. In April 1981, Marriott had determined that the "negative pressure" of the hotel contributed to the mildew problem.

30. "Negative pressure" in a building occurs when more air is exhausted from the building than is made up with conditioned air. The result is that warm, humid air will be drawn into the building to equalize the pressure.

31. By June 1981, Mariner continued to identify the "negative pressure" in the Greenspoint Marriott as contributing to the mildew problem. Marriott requested that Mariner correct the problem.

32. By August 1981, 398 rooms in the Greenspoint Marriott had been damaged by mildew. Mariner was aware that the building exhausted between 19,400 cfm and 30,294 cfm more than was made up by conditioned air. Mariner requested that Eaves, the contractor, revinyl and resheetrock all of the rooms and correct the "negative pressure" problem so that the building would have a positive pressure. Eaves did revinyl and resheetrock, but never solved the negative pressure problem.

33. Mariner and Bennett were informed in June 1981 that the "negative pressure" problem could have been resolved at a cost of between $125,000 and $175,000. At such time, legitimate business questions existed as to the complete cause of the mildew problem: who was responsible for it, and what was the most reasonable and economical method of attempting to cure same.

34. In the summer of 1982, after all of the rooms at the Greenspoint Marriott had been revinyled and resheetrocked, mildew again appeared in numerous guest rooms. It was noted by the manager of the hotel at that time that it was obvious that they would be revinyling rooms until everyone was "old and gray" unless the "negative pressure" problem was rectified.

(Bankruptcy Court Opinion at 2-9, R. at 244-51).

In addition to the defalcations described above, the Bankruptcy Court found that No. 20 leased for use at the Greenspoint Marriott various items of equipment, including a trash compactor, vans, outside signs, mobile beepers, trucks, security systems, copy machines, postage machines, communications systems and PBX system. All of these items of equipment could have been purchased

by No. 20 before the Greenspoint Marriott was completed and opened. Instead, the items were leased and charged to M/G and the limited partners (Bankruptcy Court Opinion at 28-31, R. at 270-73). Bennett and No. 20 were obligated to equip the establishment so that it could be run as a first-class hotel, and the equipment rented by the M/G was necessary so that the Greenspoint Marriott could be operated as a first-class hotel. By entering into lease agreements and charging the lease costs to M/G, the Bankruptcy Court found that No. 20 committed defalcations totalling $832,204.40.

In addition, the evidence supported by the following findings proposed by Appellants, though not specifically found by the court:

1. Archie Bennett was made aware of the mildew problem at the Brookhollow Marriott, but did nothing prior to the opening of the Greenspoint Marriott to change or alter its design. By January 1981, 196 rooms at the Brookhollow Marriott had mildew. (Transcript of Trial (Tr.) at 32, 33, 34; Pl. Ex. 7, 10).

2. Another contributing factor to the mildew problem was Mariner's utilization of General Electric Zone Line air conditioners, which were defectively designed and manufactured. The defective design and manufacturing of the Zone Line units caused excessive condensation accumulation in and around the walls and installation fittings by which the Zone Line units were incorporated into each room of the hotel. (Pl. Ex. 33, 34).

3. Today, the hotel still has a "negative pressure." (Tr. at 409).

4. It was the responsibility of the general partner to build, construct and equip the hotel. Thus, it was the responsibility of the general partner to

pay for all corrective construction to resolve the mildew problem. (Tr. at 68-71, 193; Pl. Ex. 2).

5. The hotel leased various items of equipment, including a trash compactor, vans, outside signs, mobile beepers, trucks, security systems, copy machines, postage machines, communications systems and PBX systems. All of these items of equipment could have been purchased by the general partner before the Greenspoint Marriott was completed and opened. Instead, the items were leased and charged to the partnership. (Tr. at 51-52, 70-71, 159-63, 179-84, 314-15, 320-21; Pl. Ex. 36, 37, 38, 39, 40).

6. It was the obligation of the general partner to equip the establishment so that it could be run as a first-class hotel. All equipment rented by the partnership was necessary so that it could be operated as a first-class hotel. The general partner did not pay the lease costs of this equipment, but instead charged the costs to the partnership. The general partner would enter into lease agreements and charge the lease costs to the partnership rather than be responsible for those costs himself. The total rental charges from the inception of the partnership through 1987 was more than $887,000. (*Id.*)

The above facts, in addition to the testimony and exhibits introduced at trial, clearly show that:

1. The hotel had design problems which were known to Bennett in August 1980, prior to opening;

2. Nothing was done to alter or correct the problem;

3. Bennett did not provide all equipment necessary to open and operate the hotel;

4. Bennett did *not* "construct, furnish and equip" the hotel with the $22,000,000;

5. The partnership, not Bennett, paid the cost of equipment rental after opening;

6. Bennett withdrew $1,000,000 from partnership funds for himself upon the opening of the hotel; and

7. Repair costs for the mildew problem, the second time, were paid from partnership funds.

As the person in control, all of these were acts of self-dealing by Bennett. That is, every act or failure to act benefitted Bennett directly. Clearly, a defalcation by a fiduciary occurred. Based on the facts, the court found that a defalcation occurred upon the payment of mildew repairs with partnership funds and upon payment for certain leases by the partnership. These amounts totaled $904,204.00.

The Bankruptcy Court acknowledged that if Bennett were a fiduciary to the limited partners of M/G, then Bennett's debt to the limited partners would not be dischargeable under 11 U.S.C. § 523(a)(4). However, the Bankruptcy Court found that Bennett was not a fiduciary within the meaning of the Bankruptcy Code, stating:

> "No. 20 was the fiduciary of [M/G] and only it had an express, technical, pre-existing trust relationship with [M/G], even though Bennett was the managing partner of No. 20. However, Bennett's individual liability comes into effect only by reason of breach of No. 20, and under [the Texas Uniform Partnership Act] § 15 . . . . TUPA § 15 makes Bennett liable for No. 20 partnership "obligations," but does not create a fiduciary relationship between Bennett and Plaintiffs.

Bankruptcy Court Opinion at 19, R. at 261. The primary case relied upon by the court to support this holding was *In re Hurbace*, 61 B.R. 563 (Bankr. W.D. Tex. 1986). The court concluded that "for § 523(a)(4) purposes, the Plaintiffs must be the beneficiaries of a trust

relationship of which Bennett, not No. 20, was the fiduciary." (Bankruptcy Court Opinion at 20, R. at 262)

The Bankruptcy Court then determined that if its decision were reversed on appeal, holding Bennett as a fiduciary to the limited partners of M/G, the proper measure of damages would be actual damages, instead of full restitution of all capital contributions made by the limited partners. The Bankruptcy Court did acknowledge that two cases, *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.) and *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex. Civ. App. 1978, writ ref'd n.r.e.), held that full restitution was the proper remedy. However, the Bankruptcy Court found if it were reversed on appeal, damages of $904,204.40, multiplied by Appellants' respective partnership interests, would constitute the amount of the nondischargeable debt owed by Bennett to Appellants (Bankruptcy Court Opinion at 35-39).

The District Court ignored the "veil" created by the Bankruptcy Court and its focus on No. 20 as an entity and stated unequivocally that "Bennett was the managing partner of the limited partnership, and Texas courts have imposed a higher degree of fiduciary duty on managing partners. . . ." (District Court Opinion at 5, R. at 401).[5] The District Court nonetheless affirmed the Bankruptcy Court, holding that there was no technical trust, but rather that Texas courts have imposed upon managing partners such as Bennett a fiduciary capacity of a constructive, not technical, trust (District Court Opinion at 5, R. at 401). The District Court also expressed concern that the "fresh start" policy of the Bankruptcy Code, of

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[5] The District Court incorrectly stated that it was Appellants' position to be that "fiduciary capacity" under Section 523(a)(4) applies to all fiduciaries recognized by the law (District Court Opinion at 3, R. at 399). Appellants argued that Bennett, as the sole managing general partner of No. 20 and M/G, had the fiduciary capacity and duty of a trustee under Texas law.

which discharge is a critical part, could be frustrated if a "fiduciary" were too broadly defined for purposes of the Section 523(a)(4) exception to discharge (District Court Opinion at 5-6, R. at 401-02). This appeal follows the District Court's opinion.

SUMMARY OF APPELLANTS' ARGUMENT

The District Court and Bankruptcy Court ered in finding that Archie Bennett, Jr., the Debtor herein, was not a "fiduciary" to the LSP Parties within the meaning of Section 523(a)(4) of the Bankruptcy Code, and that he was entitled to discharge his debt to the LSP Parties. The District Court misinterpreted settled Texas law that, as the Bankruptcy Court had correctly found, the general partner of a limited partnership or the managing partner of any partnership has a fiduciary duty rising to the level of a trustee of a formal trust.

The District Court did not address the Bankruptcy Court's findings that (1) No. 20, not Bennett himself, owed a fiduciary duty to the LSP Parties, and (2) the LSP Parties were entitled only to what the Bankruptcy Court assessed to be actual damages caused by Bennett's defalcation, and not full restitution. Appellants submit that the Bankruptcy Court erred in these holdings. Bennett was No. 20's sole managing partner, and was given an express power of attorney by the LSP Parties in the M/G Partnership Agreement. Thus, Bennett, personally, had a fiduciary duty to the LSP Parties equivalent to that of a trustee. In addition, the LSP Parties are entitled to complete restitution of their partnership contributions, or, in the alternative, to argue the issue of damages after notice and a hearing on remand.

ARGUMENT

I. MANAGING GENERAL PARTNERS OF LIMITED PARTNERSHIPS ARE TECHNICAL TRUSTEES UNDER TEXAS LAW.

This case turns on whether Archie Bennett, Jr. is a fiduciary to the LSP Parties within the meaning of Section 523(a)(4) of the Bankruptcy Code.[6] Under that section, an individual debtor is not entitled to a discharge from debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." A defalcation is a willful neglect of duty, even if not accompanied by fraud or embezzlement. *Moreno v. Ashworth* (Matter of Moreno), 892 F.2d 417, 421 (5th Cir. 1990). Whether a fiduciary relationship exists between the debtor and the creditor within the meaning of Section 523 (a)(4) is a matter of federal law. *Angelle v. Reed* (In re Angelle), 610 F.2d 1335, 1341 (5th Cir. 1980).

A "fiduciary" within the meaning of Section 523(a)(4) is narrowly construed, and applies only to fiduciaries of express or technical trusts. *Angelle*, 610 F.2d at 1339. In *Davis v. Aetna Acceptance Corp.*, 293 U.S. 328, 333 (1934), a case interpreting the predecessor of Section 523(a)(4) under the Bankruptcy Act, the Supreme Court held that the "fiduciary duty" cannot *arise* out of the wrongful act; rather, the breach of fiduciary duty "would seem to apply only to a debt created by a person who was already a fiduciary when the debt was created." (citing *Upshur v. Briscoe*, 138 U.S. 365, 378 (1890)).

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[6] Although the District Court has already reviewed this case, this Court reviews the bankruptcy court's findings as if this were an appeal from a trial in the District Court. *Killebrew v. Brewer* (In re Killebrew), 888 F.2d 1516, 1519 (5th Cir. 1989). Thus, like the District Court, this Court reviews the Bankruptcy Court's conclusions of law on an independent, *de novo* basis, and reviews the Bankruptcy Court's findings of fact under the clearly erroneous standard. *Id.* and cases cited therein; *Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1252 (5th Cir. 1986).

This prinicple, which dates back to 1844, allows a state to enact statutes that impose technical trustee-like duties on persons, and thus subject those persons to challenges to discharge under Section 523(a)(4) of the Bankruptcy Code. *See Hayton v. Eichelberger* (In re Eichelberger), 100 B.R. 861, 862-63 (Bankr. S.D. Tex. 1989) (referring to *Chapman v. Forsyth*, 43 U.S. (2 How) 202, 11 L.Ed. 236 (1844)).

Although the concept of fiduciary is narrowly construed under federal law, reference to state law is necessary to determine whether a technical trust exists. *See Angelle*, 610 F.2d at 1341, *Ragsdale v. Haller*, 780 F.2d 794, 796 (9th Cir. 1986); *In re Hurbace*, 61 B.R. 563, 565 (Bankr. W.D. Tex. 1986). Here, the District Court reviewed Texas law and found no technical trust exists between managing general partners and limited partners. (District Court Opinion at 5-6, R. at 401-02). This was error.

Oddly enough, the District Court, though affirming the judgment of the Bankruptcy Court, ignored the correct holding of that court on this issue. (*See* Bankruptcy Court Opinion at 14, R. at 256). Texas courts have not held that partners have a technical trust relationship simply because they are partners. However, if one partner is the managing partner or is the general partner of a limited partnership, a technical fiduciary relationship does exist. *See Hurbace*, 61 B.R. at 566.

In *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir. 1986), the Ninth Circuit considered the duties between partners under California law. There, the court held that, since all partners under California law have a trustee's fiduciary duty, the debtor was a fiduciary for purposes of Section 523(a)(4). *Id.* at 796-97.

In *Hurbace*, the court noted that Texas law did not confer a trustee's fiduciary duty upon all partners. However, as the court in *Hurbace* discussed, the imposition

of a higher fiduciary duty under state law as described in *Ragsdale* did exist in Texas for managing partners. *See Huffington v. Upchurch*, 532 S.W.2d 596, 579 (Tex. 1976); *Crenshaw v. Swenson*, 611 S.W.2d 886 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.). Further, it is well settled law in Texas that the managing general partner acting in complete control, under the Texas Uniform Limited Partnership Act, stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust. *Partnership*, 57 Tex. Jur. 3d at ¶ 271 at 651-52; *Moncrief v. United States*, 730 F.2d 276, 285 (5th Cir. 1984); *Crenshaw v. Swenson, supra*, 611 S.W.2d at 890; *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex. Civ. App.—Austin 1978, writ ref'd n.r.e.). Thus, in this case the District Court was in error in holding that the general partner (Bennett or No. 20) was not a technical trustee to the limited partners.

Further, the District Court was incorrect in holding that cases such as *Huffington* and *Crenshaw* impose "constructive" trusts on managing partners. A constructive trust is not a trust in the formal sense. It is an equitable remedy for fraud, unjust enrichment, or other wrongful conduct warranting the imposition of a trust to further equity. *See, e.g., Bocanegra v. Aetna Life Ins. Co.*, 605 S.W.2d 848, 851 (Tex. 1980). *Huffington* and *Crenshaw* have nothing to do with constructive trusts; they make no mention of constructive trusts. In fact, these cases squarely hold that a managing partner of a general partnership or the general partner of a limited partnership has the same fiduciary duty as a trustee, one of the highest fiduciary duties recognized in the law. *Huffington*, 532 S.W.2d at 579; *Crenshaw*, 611 S.W.2d at 890.

The District Court's misapplied Texas law to the facts. In this case, Bennett was the sole managing general partner. There was a trust document, namely the Partnership Agreement, under which Bennett, as managing

partner of No. 20 and with the power of attorney from the LSP Parties, took on the role of trustee under Texas law on behalf of M/G's limited partners. Under Texas law, his fiduciary duty is clearly that of a trustee. Accordingly, Bennett's debt to the limited partners of M G is not dischargeable.

As one bankruptcy court has noted, a person such as Bennett is not merely a partner. Where the debtor is the sole managing partner of the limited partnership, the person with total control over its finances, "the relationship between [the sole managing partner] and his partners is characterized by all the typical attributes of a technical trust. He had all those responsibilities which are commonly associated with a trustee, including those of collecting, segregating, investing, dispersing, and accounting for the funds." *Arnett v. Weiner* (In re Weiner), 95 B.R. 204, 207 (Bankr. D. Kan. 1989).

The District Court's concern that an overbroad definition of a "fiduciary" would defeat the 'fresh start" policy inherent in the Bankruptcy Code should not exist under the facts of this case. Bennett was *not* an honest debtor. The Bankruptcy Court found that over $900,000 of defalcations were committed by No. 20, which was controlled by Bennett as sole managing general partner. Moreover, it was clear in the record and findings that Bennett was able to pocket $1 million for himself by cutting corners on the HVAC design and not providing all of the equipment for the hotel as required. As the Ninth Circuit Court of Appeals stated in *Ragsdale*, "[T]he purpose of the Bankruptcy Act is to grant a discharge of honest debts to honest debtors, not to grant discharges to those who have dishonestly misappropriated funds entrusted to them.' *Ragsdale*, 780 F.2d at 797.

The M/G limited partners had no control over the affairs of the business. All management control was held by Bennett. Thus, like the beneficiaries of a trust, the limited partners of M/G entrusted their investment to

Bennett and, like a trustee, he owed them the highest fiduciary known to the law. He must administer the partnership affairs solely for the benefit of the partnership and he is not permitted to place himself in a position where it would be to his benefit to violate his duty. *See Crenshaw v. Swenson*, 611 S.W.2d at 890. Here, Bennett profited from self-dealing, he profited by deciding that enough had been spent by the partnership on design and construction of the hotel and that equipment should be leased with the partnership paying the rent so that, upon opening, a $1 million distribution would come directly to him.

This case presents the first opportunity for the Fifth Circuit Court of Appeals to adopt the reasoning set forth in *Ragsdale*, *Hurbace*, and *Weiner*, and hold that managing general partners of Texas limited partnerships are fiduciaries within the meaning of 11 U.S.C. § 523(a)(4). For these reasons, Bennett is a fiduciary to the LSP Parties and is not entitled to a discharge of his debt to the LSP Parties, and this Court should reverse the judgment of the District Court and the Bankruptcy Court.

II. BENNETT WAS THE FIDUCIARY

What is wrong with this picture?

> Jones and Smith are general partners of the JS Trust Company. Daddy Warbucks dies leaving $1,000,000 in trust for Little Orphan Annie, naming JS Trust Company as Trustee. Jones and Smith, tiring of the trust business, close the doors, split the $1,000,000 and each buy a house in Highland Park. Both file for Chapter 7, claiming the houses as homestead. Annie objects to their discharge and is told she should look to JS Trust Company, her fiduciary.

That cannot be right! But according to the opinion below, that is what happens. Clearly, the holding is erroneous, as a matter of law.

Here, the Bankruptcy Court found a fiduciary existed and that fiduciary, No. 20, committed a defalcation within the meaning of § 523(a)(4) (Bankruptcy Court Opinion at 19, R. at 261). Thus, if No. 20 were the debtor, it would not get a discharge. The District Court affirmed.

The Bankruptcy Court's holding, however, turns on its implicit finding that Bennett's liability "comes into effect only by reason of breach by No. 20." (Bankruptcy Court Opinion at 19, R. at 261) Stated another way, the Bankruptcy Court held that when No. 20 stole the money, a constructive trust resulted in favor of Plaintiffs with Bennett as the obligor, and thus, Bennett was not a fiduciary within § 523(a)(4). To reach this conclusion, the Bankruptcy Court ignored both the specifics of the M/G Partnership Agreement and Texas partnership law.

A. *Partners Are Jointly and Severally Liable for All Partnership Obligations*

As noted by the Bankruptcy Court below:

> All partners are jointly and severally liable for all debts and obligations of the partnership, including the obligations under Section 13 and 14.

Tex. Uniform Partnership Act, Art. 6132b § 15 (Vernon 1970) (Quoted in Bankruptcy Court Opinion at 18, R. at 260). The effect of this statute is that partners can be sued directly without the necessity of proceeding against the partnership or joining it in the suit. *Foster v. Daon Corp.*, 713 F.2d 148, 151 (5th Cir. 1983).[7] In other words, if the partnership has the obligation, the individual general partner has the obligation. Thus, if No. 20

[7] The Texas Revised Limited Partnership Act, Art. 6132a-1, § 4.03(a), provides that "Except as provided by this Act or a partnership agreement, a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners."

is a trustee of an express trust (as the managing general partner of a Texas limited partnership), then, as a matter of law, all of No. 20's general partners are obligated as trustees.

Further, the Bankruptcy Court cited Sections 13 and 14 of the Texas Uniform Partnership Act, but ignored the contents of those sections:

> § 13. Partnership Bound by Partner's Wrongful Act
>
> Sec. 13. Where, by any wrongful act of omission of any partner acting in the ordinary course of the business of the partnership or with the authority of his co-partners, loss or injury is cause to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act.
>
> § 14. Partnership Bound by Partner's Breach of Trust
>
> Sec. 14. The partnership is bound to make good the loss:
>
> (a) Where one partner acting within the scope of his apparent authority receives money or propery of a third person and misapplies it; and
>
> (b) Where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership.

These obligations are *specifically* included as the joint and several obligations of each partner under Section 15. Therefore, each partner is personally obligated where the partnership receives money or property of a third person and misapplies it. Here, the creation of the M/G limited

partnership with No. 20 as its general partner specifically created a technical trust, with Bennett having the obligations and liabilities of a trustee.

Without question, under the Uniform Partnership Act and the common law, partners are jointly and severally obligated for partnership obligations. *Smith v. Wayman,* 224 S.W.2d 211 (Tex. 1949). This includes contract obligations, *Rhodie v. Washington,* 641 S.W.2d 317, 320 (Tex. App.-El Paso 1982, writ ref'd n.r.e.) (general partner individually liable for debt of bankruptcy limited partnership); torts, *Kent v. National Supply of Texas,* 36 S.W.2d 811 (Tex. Civ. App.—Waco 1931, writ ref'd) (conversion); deceptive trade practices, *Foster v. Daon Corp., supra,* 713 F.2d at 151; and fiduciary duties, *Cook v. Brundidge, Fountain, Elliot and Churchill,* 533 S.W.2d 751 (Tex. 1976); *FDIC v. Braemoor Associates,* 686 F.2d 550, 556-558 (7th Cir. 1982).

In *Cook,* the client of a law firm sued the firm for breach of fiduciary duty and fraud resulting from the acts of one of the partners. Mr. Lyon, a partner in the firm, had convinced his client to invest in a company, where he was an officer and shareholder. This company then went bankrupt. The court relied on the provisions of the Texas Uniform Partnership Act quoted above holding that, if it were established that the funds were misapplied and that Lyon was carrying on the business of the firm, then the liability of the firm would follow. *Id.* at 758-759.

The present case is analogous to *Cook.* Here, the Bankruptcy Court found that No. 20 defalcated over $900,000. That *must* be the equivalent of saying Bennett defalcated these amounts; otherwise, the statutes quoted above are meaningless.

The express trustee-beneficiary relationship between Bennett and Appellants is amply demonstrated by *Crenshaw v. Swenson.* In that case, the limited partnership had, as its general partner, a general partnership known

as Occidental Syndicated Investments. Occidental originally was comprised of three individuals, including Swenson. However, two members resigned, leaving Crenshaw as the sole general partner of the general partner. Suit was brought against Swenson individually for breach of fiduciary duty. The trial court found that Swenson had transferred partnership property to a corporation controlled by her, and had deposited proceeds of a sale of partnership assets into the corporation's account. The trial court failed to find a breach of fiduciary duty. The appellate court reversed and rendered on this point, holding that Swenson, the general partner of the general partner breached *her fiduciary duty to the limited partners* as a matter of law. *Id.* at 891.

The same is true here. Bennett and No. 20 cannot be separated by a nonexistent legal fiction.[8] The acts of Bennett are the acts of No. 20 and vice versa. Bennett is obligated as the general partner of M/G because he is the general partner of No. 20. He was a fiduciary to Plaintiffs under an express pre-existing trust relationship: the M/G Partnership Agreement.

B. *The Bankruptcy Court Ignored Specific Provisions of the Partnership Agreement*

The Bankruptcy Court ignored specific provisions of the partnership agreement and the fact that Bennett benefitted personally by the defalcations. Bennett was not No. 20's "alter ego." He *was* No. 20! He personally was solely responsible for carrying out the obligations of the managing general partner of the M/G partnership. Ob-

[8] The discussion in the Bankruptcy Court's Memorandum Opinion regarding "piercing the entity of No. 20" is misplaced. (Bankruptcy Court Opinion at 15-17, R. at 257-59). At common law, a partnership is not a legal entity, but only a contractual status. *Kent v. National Supply Co., supra.* The Uniform Partnership Act does not alter this concept where the individual liability is concerned. *See* §§ 13, 14, and 15, Art. 6132(b), *supra.*

viously, *somebody* had a fiduciary duty to the LSP Parties, and that was Bennett.

Article 10 of the Partnership Agreement prohibited Bennett from voluntarily withdrawing as the general partner of No. 20. Bennett further represented and warranted in that Agreement that, during the term of the Agreement, he would not alter his ownership of his general partnership interest in No. 20, except as otherwise provided in the Agreement. This unambiguous contractual provision, taken with Bennett's status as sole general partner, assured the limited partners that Bennett, and Bennett alone, would be in charge of the project. Whatever No. 20 did was ultimately a result of Bennett's decision. Whatever benefit it derived went to Bennett. Indeed, as the Bankruptcy Court found, all savings on the project went directly to Bennett (Bankruptcy Court Opinion at 6, R. at 248).

Further, under Section 12.5 of the Partnership Agreement, each limited partner appointed Bennett as his attorney to execute all documents on behalf of M/G. Accordingly, this court need not go beyond the terms of the Partnership Agreement itself to find that Bennett owed a direct fiduciary duty to Appellants, and that this fiduciary relationship, under Texas law, rose to the level of the fiduciary duty a trustee owes to its beneficiaries.

C. *Bennett Took the Money*

It cannot be overemphasized that the LSP Parties had no control over the affairs and financial management of the Greenspoint Marriott. Bennett, and only Bennett, had this control. To say that "No. 20" had control is a misnomer, because unlike a corporation, a partnership is not, for liability purposes, a separate entity from its partners.

Bennett was the human being who controlled the actions of No. 20 and M/G. No other person was available.

The only person who could and did decide to: (1) do nothing to solve the negative presure problem, (2) do nothing to alter the design of the hotel when warned by Marriott, (3) fail to furnish equipment, but charge the partnership for equipment rental, (4) take $1,000,000 as "savings" despite the above and (5) charge the partnership for the cost of mildew repairs.

Bennett, not No. 20, took the $1,000,000 distribution. This was an additional defalcation not found by the Bankruptcy Court below. Bennett intentionally arranged for the employment of an unbondable contractor so that the Greenspoint Marriott project could be completed under budget by $1,000,000. Bennett stacked the cards so that he would receive the distribution. He ignored mistakes inherent in the design of the hotel. He installed defective air conditioning equipment. (Pl. Ex. 33, 34). Bennett did not satisfy his obligation to the limited partners to deliver a first-class hotel and, yet, still took $1,000,000 out of partnership funds, for himself.

By applying settled principles of law established above, this Court should find that Bennett committed an additional defalcation when he arranged for the distribution of the $1,000,000 to himself. The Bankruptcy Court below found that No. 20 defalcated over $900,000 which, based on the record and the law, was clearly the act of Bennett. However, the $1,000,000 distribution in 1981 should never have been made, and it is an additional defalcation to be added to the amounts found by the court below.

Throughout the trial stage of the case and on appeal, Bennett has argued that the LSP Parties would have to "pierce" the veil of No. 20, or show that No. 20 was Bennett's "alter ego," in order to recover from Bennett. The Bankruptcy Court seemed to find merit in this position, and cited extensively from *Grierson v. Parker Energy Partners*, 737 S.W.2d 375 (Tex. Civ. App.—Houston

1987, no writ) (Bankruptcy Court Opinion at 15-17, R. at 257-59). *Grierson* was a case where the general partner of a limited partnership was a corporation (in contrast to this case, where No. 20 was a limited partnership controlled by Bennett). The court in *Grierson* refused to hold the individual controlling the corporate general partner liable on the ground that the corporation, not the individual, owed the fiduciary duty.

Bennett's unusual "partnership veil" position has no merit. Under the Texas Uniform Partnership Act, specifically the provisions cited above, a "partnership veil" simply cannot exist. The limited liability of stockholders traditionally associated with corporations does not exist for general partners of either general or limited partnerships. This distinction is one of the most critical differences between corporations and partnerships. Neither Bennett, who raised this argument, nor the Bankruptcy Court, which agreed with Bennett's veil piercing argument, have cited *any* cases where such a phenomenon actually took place. Here, Bennett is fully liable for *his* wrongs and should not be discharged.

III. APPELLANTS ARE ENTITLED TO RESTITUTION, OR IN THE ALTERNATIVE, AN OPPORTUNITY TO BRIEF THE ISSUE OF DAMAGES ON REMAND

The District Court held that Bennett was not liable under Section 523(a)(4), and never reached the Bankruptcy Court's decision regarding damages. The Bankruptcy Court, anticipating its decision could be reversed on appeal, set forth in detail its determination and calculation of actual damages it considered nondischargeable if it were reversed. If this Court reverses the District and Bankruptcy Courts, the issue of damages must then be addressed by this Court. Appellants contend here, as they did in the District Court, that the Bankruptcy Court erred (1) in finding that the LSP Parties were only

entitled to actual damages rather than equitable restitution, and (2) determining damages without notice to the LSP Parties.

Nearly half of the Bankruptcy Court's Memorandum Opinion anticipated that its decision would be reversed upon appeal. To that end, the Bankruptcy Court offered an extensive analysis of the leases entered into by No. 20, describing which leases constituted defalcations not dischargeable under § 523(a)(4).[9] If this Court reverses the District and Bankruptcy Courts, as it should, then the determination of the Bankruptcy Court that these leases constituted defalcations is controlling, because these findings were not challenged by Bennett. The question at this point, is however, whether the Bankruptcy Court should have addressed the measure of damages issue at all. For the following reasons, the Bankruptcy Court incorrectly concluded that the LSP Parties were entitled only to recover actual damages and not full restitution.

A. *Equitable Restitution Is the Appropriate Remedy*

The Bankruptcy Court was troubled with the possibility that full restitution should be awarded under Texas law "regardless of whether the defalcation was for $10.00 or for $10 million." Initially, it should be noted that this concern is not one which the Bankruptcy Court or this court need address, since more than $10.00 was defalcated. In fact, the Bankruptcy Court acknowledged that over $900,000 was defalcated. Moreover, this $900,000 does

[9] It should be noted that the mere fact that equipment necessary to open and operate the hotel was not provided by Bennett was a defalcation. The equipment that was leased could have been bought. (Tr. at 51-52, 70-71, 159-63, 314-315, 320-21; Pl. Ex. 36). By not buying the equipment, a distribution of $1,000,000 was available and made to Bennett. (Bankruptcy Court Opinion at 6, R. at 248). Bennett did not pay the rental expenses; rather, they were paid by the partnership. Total rental expense was $887,000 (Pl. Ex. 36-40). The court found $832,204 as being the subject of a defalcation. (Bankruptcy Court Opinion at 31, R. at 273).

not include the $1,000,000 Bennett defalcated when he distributed that amount to himself upon the opening of the hotel.

The Bankruptcy Court also found that despite the existence of controlling authority, *Crenshaw v. Swenson* and *Watson v. Limited Partners of WCKT, Ltd.*, it would not award full restitution as damages to the limited partners of M/G. The court noted:

> The damage issue is straightforward and would not be complicated if it were not for the seminal case of *Watson* . . . . There, the Austin Court of Appeals, in awarding restitution, held that it was not necessary that there be proximate cause between the breach and the damages awarded because the fiduciary breached his duties, and, thus, the limited partners were entitled to restitution of their entire investment as a matter of law. [citations omitted] In *Crenshaw, supra* at 891, the court stated, "courts are ill-equipped to discern the extent a conflict of interest *may* have affected the outcome of any given transaction . . . .
>
> The cited cases in *Watson* only held that, if a fiduciary breaches his duties, he forfeits his *right to compensation* as a matter of law, without regard to whether there is proximate cause between the breach and the damages. Those cases do not hold that the injured beneficiaries of the fiduciary relationship are entitled to *restitution of their entire investment*, without regard to proximate cause.

(Bankruptcy Court Opinion at 36-37, R. at 278-79 (emphasis in original)).

Both the reasoning and conclusion of the Bankruptcy Court are flawed. First, the Bankruptcy Court's decision in this case is directly contrary to the settled rulings in *Crenshaw* and in *Watson*. The Bankruptcy Court is only supposed to apply Texas law, not decide what it should be. *Cf. Butner v. United States*, 440 U.S. 48 (1979).

Second, the Bankruptcy Court's strained construction of the opinion in *Watson* ignores the holding of the court there. The *Watson* court relied on prior Texas Supreme Court precedent: *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942).

> It is beside the point for either Turner or Corbett to say that Kinzbach suffered no damages because it received full value for what it has paid and agreed to pay. A fiduciary cannot say to the one whom he bears such relationship: You have sustained no loss by my misconduct in receiving a commission from a party opposite to you, and therefore you are without remedy. *It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired.* It is the law in such instances if the fiduciary takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principle, without a full disclosure, it is a betrayel of his trust and a breach of confidence, *and he must account to his principal for all he has received.*

Kinzbach, 160 S.W. at 514 (emphasis added; citations omitted).

The Bankruptcy Court noted that in some instances a fiduciary must forfeit his right to compensation. *Citing Kinzbach Tool, supra; Anderson v. Griffith*, 501 S.W.2d 695 (Tex. Civ. App.—Fort Worth 1973, writ ref'd n.r.e.) and *Russell v. Truitt*, 531 S.W.2d 948 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.). The Bankruptcy Court noted that those cases "do not hold that injured beneficiaries of the fiduciary relationship are entitled to restitution of their entire investment. . . ." (Bankruptcy Court Opinion at 36-37, R. at 278-79). This should come as no surprise. The cases cited did not involve invest-

ments or the misuse of trust funds held by a trustee. They all involved commissions wrongfully obtained by agents. The agents had to account for all that they received. So does Bennett.

The facts found by the court below demonstrate clearly that in this case there was a defalcation by a fiduciary through acts of self dealing. There is no requirement of proximate cause. Beneficiaries of a trust may attack self-dealing transactions by a trustee, even if they suffer no damages and even if the trustee acts in good faith. *Slay v. Burnett Trust*, 143 Tex. 621, 187 S.W.2d 377, 389 (1945); *Harvey v. Casbeer*, 531 S.W.2d 206 (Tex. Civ. App.—Tyler 1975, no writ). Upon a finding of breach, the trustee must account for all he has received. *Watson, supra*, 570 S.W.2d at 182.

In *Watson*, the court held that restitution was a recognized measure of recovery and that a showing of proximate cause of actual loss was not required. 570 S.W.2d at 182; *Russell v. Truitt*, 554 S.W.2d 948 (Tex. Civ. App.—Fort Worth 1977, writ ref'd n.r.e.). The court noted that suits such as this are to recover money had and received, and the money received by the general partner as contributions by the limited partners were due as restitution. *Id.*

The Bankruptcy Court chose to ignore *Crenshaw v. Swenson* because it cited *Watson* for a different proposition (Bankruptcy Court Opinion at 37 n.2, R. at 279 n.2). However, the court in *Crenshaw* clearly held that no damages need be shown and that, upon a showing of a breach of fiduciary duty, the limited partners were entitled to equitable restitution of their partnership contribution. 611 S.W.2d at 891. It should be noted again that Swenson was the general partner of the general partner of the limited partnership.

Third, the Bankruptcy Court's notation that "[a] plaintiff must introduce sufficient evidence to provide a trier

of fact with an intelligent means in determining an appropriate damage award without speculation or conjecture," Bankruptcy Court Opinion at 38, R. at 280, is an argument which favors *Appellants,* not Bennett. Speculation or conjecture is far greater with respect to damages when a court reviews several leases and engages in a complicated analysis of actual damages, instead of simply awarding full restitution to the wronged parties. In this case, the parties stipulated the amounts of Appellants' investments in the partnership. (*See* Stipulation filed August 23, 1989, found in Record Excerpts). The contributions by the limited partners are certain and easier to quantify when compared to an analysis of which leases were proper and which were not. The Bankruptcy Court should not have substituted its decision in the face of such overwhelming Texas law to the contrary.

Apparently, the Bankruptcy Court assumed that it was required to calculate, *sua sponte,* the amount of damages in this case. The LSP Parties' Complaint to Determine Dischargeability of Debt did not ask for damages; it merely sought to render Bennett's debt nondischargeable. The LSP Parties filed a proof of claim for the full amount of restitution that they sought, which Bennett has not challenged. The Bankruptcy Court erred in reaching the damage issue at all. Other courts addressing this issue have held that liquidation of a debt is not related to whether that debt is dischargeable. *See In re Stelweck,* 86 B.R. 833, 844-45 (Bankr. E.D. Pa. 1988), *aff'd,* 108 B.R. 488 (E.D. Pa. 1989); *In re Crist,* 85 B.R. 807, 816 (Bankr. N.D. Iowa 1988); *In re Lambert,* 59 B.R. 503, 517 (Bankr. M.D. Ala. 1986).

Prior to the Bankruptcy Code's enactment in 1978, Bankruptcy Courts were required under Section 17c(3) of the old Bankruptcy Act, to "determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof" if it found that a debt was nondischargeable. This language was omitted from Sec-

tion 523 of the Bankruptcy Code, which is the successor to old section 17c(3). Indeed, Section 523 is silent as to the liquidation of nondischargeable debts. The reason for this is that, under the Code, the proper procedure for determining the amount of claims is for the debtor to object to the claim and institute the claims objection procedure described in Section 502 of the Code and Bankruptcy Rules 3001-3008. Thus, the Bankruptcy Court's *sua sponte* calculation of damages was neither required, necessary, or appropriate under the Bankruptcy Code.

It is certainly possible that a creditor challenging the dischargeability of a debt could ask in its complaint that the amount of that debt be determined. Here, however, the LSP Parties did not ask for such a determination. The LSP Parties had no notice whatsoever that the Bankruptcy Court would make any determination as to damages.

Some courts have adhered to the procedure described in old Section 17c(3), and cite as their authority provisions and cases under the old Bankruptcy Act. *In re Lorren,* 45 B.R. 584, 589 (Bankr. N.D. Ala. 1984); *In re Cope,* 35 B.R. 287, 288 (Bankr. W.D. Mich. 1983). Other cases, cited by Bennett in his brief on appeal to the District Court, have simply assumed, without any authority, that damages should be determined after debts are held to be nondischargeable. It is impossible to tell from these cases whether the creditor actually requested such a determination in its complaint to determine the dischargeability of the debt. Regardless of whether those courts were justified, in this case, damages were determined without any notice, and without any request for the determination of damages by any party. Clearly, the LCP Parties are entitled to at least an opportunity to present its case for full restitution with *some* notice, should this matter be remanded to the Bankruptcy Court.

CONCLUSION

For all of the reasons stated above, the LSP Parties respectfully request that this Court issue a Mandate: (1) reversing the December 14, 1990 Memorandum Order and Judgment of the District Court and (2) reversing the Memorandum Opinion and Final Judgment of the Bankruptcy Court in all respects; and (3) rendering judgment that Bennett's entire debt to the LSP Parties is not dischargeable or, in the alternative, to remand this case for the determination of the LSP Parties' entitlement to equitable restitution, as discussed herein.

DATED this 18th day of March, 1991.

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. CA3-90-0766-G

LSP INVESTMENT PARTNERSHIP *et al.*,
Appellants,

VS.

ARCHIE BENNETT, JR.,
Appellee.

On Appeal from the United States Bankruptcy Court
Northern District of Texas, Dallas Division

BRIEF FOR APPELLANT

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STATEMENT OF BASIS FOR APPELLATE JURISDICTION AND REQUEST FOR ORAL ARGUMENT PURSUANT TO FED. R. BANKR. P. 8012

Section 158(a), 28 U.S.C., provides that the federal district courts "shall have jurisdiction to hear appeals from final judgments, orders, and decrees . . . of bankruptcy judges entered in cases and proceedings under section 157 of this title. An appeal under this subsection shall be taken only to the district court for the judicial district in which the bankruptcy judge is serving." Under 28 U.S.C. § 157(b)(2)(I), core proceedings properly before the bankruptcy court include proceedings involving determinations as to the dischargeability of particular debts.

On February 20, 1990, the bankruptcy court signed a Memorandum Opinion and Final Judgment granting the Debtor, Archie Bennett, Jr., (also "Bennett") a discharge as to the debt challenged by Plaintiffs LSP Investment Partnership, *et al.* in Adversary No. 389-3110. Plaintiffs, Appellants herein, filed a Notice of Appeal on March 1, 1990, and filed their Designation of Record and Statement of Issues on Appeal on March 9, 1990. Accordingly, Appellants have complied with all jurisdictional and procedural prerequisites for the district court to consider this appeal, and the district court has jurisdiction to adjudicate this appeal under 28 U.S.C. § 158(a).

Appellants request that this court hear oral argument in this appeal pursuant to Fed. R. Bankr. P. 8012. Appellants sincerely believe that the bankruptcy court committed several critical errors of law which prejudiced the right of Appellants to the return of over $3.2 million from Bennett. Virtually half of the bankruptcy court's Memorandum Opinion anticipates its decision might be reversed by this court on appeal.

As more fully set forth below, the bankruptcy court also found that Bennett's limited partnership, of which

Bennett was the sole general partner and managing partner, committed defalcations against Appellants. This finding was not appealed by Bennett.

For all of these reasons, Appellants urge this court to allow oral argument unless this court determines from the briefs and record on appeal that Appellants are entitled to a reversal of the bankruptcy court's February 20, 1990 Final Judgment without the need for oral argument.

STATEMENT OF ISSUES PRESENTED AND STANDARD OF APPELLATE REVIEW

Appellants LSP Investment Partnership, et al., Plaintiffs in Adversary No. 389-3110 heard before the bankruptcy court below, offer the following issues in this appeal:

1. Did the bankruptcy court err in finding that Archie Bennett, Jr. was entitled to a discharge with respect to debts incurred by Bennett owing to Plaintiffs in Adversary No. 389-3110 (which is on appeal before this court)?

This issue encompasses the following sub-issues:

   a. Did the bankruptcy court err in finding that Archie Bennett, Jr. was not a fiduciary to Plaintiffs in Adversary No. 389-3110 within the meaning of 11 U.S.C. § 523(a)(4)?

   b. Did the bankruptcy court err in failing to find that a defalcation occurred when Bennett received a $1 million distribution upon the opening of the hotel which he knew had a substandard design in its HVAC system (negative pressure) and where he had not provided, as required, all equipment necessary to open and operate a fully equipped hotel?

2. Did the bankruptcy court err in its contingent calculation of damages in the event that its finding would be reversed on appeal?

This issue encompasses the following sub-issues:

a. Did the bankruptcy court err in its contingent finding that Plaintiffs in Adversary No. 389-3110 were not entitled to full restitution of their investment in the event that the bankruptcy court's findings were reversed on appeal?

b. Did the bankruptcy court err in making findings related to Plaintiffs' direct claims against Bennett when this case only concerned an objection to discharge for Plaintiffs' claims, did not involve plaintiffs' proofs of claim, and was not consolidated with Plaintiffs' state court suit against Bennett and Mariner Interest No. 20?

The standard for a district court's disposition of an appeal from the bankruptcy court is set forth in Rule 8013 of the Federal Rules of Bankruptcy Procedure:

> "On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses."

Under settled Fifth Circuit law, the district court reviews the bankruptcy court's findings of fact under a clearly erroneous standard. The bankruptcy court's conclusions of law are reviewed *de novo*. *See Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1252 (5th Cir. 1986); *In re Ambassador Park Hotel, Ltd.*, 61 B.R. 792, 798-99 (N.D. Tex. 1986). The district court must then independently determine the correctness of the bankruptcy court's legal conclusions, and reverse the bankruptcy court's judgment "if based upon an incorrect view of applicable law." *In re Parrish*, 76 B.R. 14, 16 (N.D.

Tex. 1987); *In re Cumpton*, 30 B.R. 49, 50 (N.D. Tex. 1983). Furthermore, the district court should conduct a *de novo* review of mixed questions of law and fact. *See In re Mader*, 108 B.R. 643, 644 (N.D. Ill. 1989) and cases cited therein.

STATEMENT OF PROCEDURAL HISTORY OF THE ADVERSARY PROCEEDING APPEALED TO THIS COURT

On November 23, 1988, Archie Bennett, Jr. filed a Voluntary Petition under Chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq.*, Case No. 388-37142-RCM-7. Bennett's bankruptcy filing stayed a state court lawsuit, *LSP Investment Partnership, et al. v. Mariner Interest No. 20, Ltd. and Archie Bennett, Jr.*, Cause No. 84-69448, in the District Court of Harris County, Texas, 234th Judicial District, brought by Plaintiffs (Appellants herein) who were limited partners in a partnership known as Mariner Greenspoint, Ltd. A true and correct copy of Plaintiffs' First Amended Original Petition in the state court lawsuit is shown in Appendix A.

Plaintiffs filed to remove the state court lawsuit to the bankruptcy court and filed a Complaint to Determine Dischargeability of Debt, Adversary Proceeding No. 389-3110, on February 17, 1989 (Item 1 of Appellants' Designation of Record). Plaintiffs moved to consolidate the removed claims with Adversary Proceeding No. 389-3110. The motion was denied orally and without order at a status conference held by the bankruptcy court on or about May 16, 1989. A true and correct copy of Plaintiffs' Motion to Consolidate is presented as Appendix B.

Both Plaintiffs and Defendant (Bennett) filed motions for summary judgment in the adversary proceeding. These motions were denied by the bankruptcy court orally and without order on December 11, 1989. (*See* Items 3, 6, 7, and 9 of Appellants' Designation of Record and Items 2 and 3 of Appellee's Designation of Additional Items to be Included in Record on Appeal.)

Trial was held in the adversary proceeding on December 18-20, 1989. The transcript of the trial is located at Item 15 of Appellants' Designation of Record. On February 20, 1990, the bankruptcy court signed a Memorandum Opinion and Final Judgment granting Bennett a discharge. The bankruptcy court also found that, if part of its order were reversed on appeal, Plaintiffs were entitled only to certain sums of money equal to $832,204.00. This sum resulted from defalcations related to certain leases and related to the expenditure of partnership funds for mildew repair. Consequently, the court denied Plaintiffs full restitution of their contributions. Memorandum Opinion at 12, 31. The Memorandum Opinion and Final Judgment are found at Items 14 and 15 of Appellants' Designation of Record.

Plaintiffs filed a Notice of Appeal on March 1, 1990.

PRELIMINARY STATEMENT

Archie Bennett, Jr., the Debtor herein, was the sole general partner of Mariner Interest No. 20, which in turn was the sole general partner of Mariner/Greenspoint, Ltd. Appellants, some of the limited partners of Mariner/Greenspoint, Ltd. and Plaintiffs below, raise two legal issues on appeal. First, the bankruptcy court held that Bennett was not a fiduciary to Plaintiffs within the meaning of 11 U.S.C. § 523(a)(4). This holding is incorrect, as a matter of law. The bankruptcy court erred because it ignored Texas partnership law and dispositive authority in making its decision. Bennett clearly was a fiduciary.

Second, the bankruptcy court held that, if it were reversed on appeal, Appellants would not be entitled to receive full restitution of their contributions to the partnership. Instead, the court concluded Appellants were entitled only to recover damages constituting actual defalcations committed by Bennett and Mariner Interest No. 20. This holding of the bankruptcy court is incorrect for two reasons: (1) The bankruptcy court's ruling is con-

trary to settled Texas law stated in cases such as *Crenshaw v. Swenson*, 611 S.W. 2d 886 (Tex. Civ. App.—Austin, writ ref'd n.r.e.) and *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex. Civ. App.—Austin 1978, writ ref'd n.r.e.) (full restitution is the appropriate remedy); and (2) The only issue before the bankruptcy court was whether Bennett's debt to Appellants was dischargeable, not the amount of Appellants' claim. For these reasons, Appellants urge this court to reverse the bankruptcy court's ruling.

STATEMENT OF FACTS

Appellants are some of the limited partners of Mariner/Greenspoint, Ltd. (also "M/G" or the "partnership"), a Texas limited partnership. The Debtor, Archie Bennett, Jr., was the sole general partner of Mariner Interest No. 20, Ltd. ("No. 20"), which was the sole general partner of M/G.[1]

The purpose of M/G was to construct and operate a Marriott hotel near Greenspoint Mall in Houston, Texas. Under the M/G partnership agreement ("Agreement"), Bennett could not voluntarily withdraw as the general partner of No. 20. Thus, since he was the sole general partner of No. 20, Bennett was the only individual who could direct the affairs of M/G. (Plaintiffs' Exhibit ("Ex.") 2 at Art. 10, pp. 36-37). M/G had available to it a $22,000,000 fund obtained from third-party financing and contributions by the limited partners. Bennett was to use these funds to pay all actual costs necessary to con-

---

[1] Graphically, the relationship of the parties is as follows:

M/G

No. 20

Bennett

The bankruptcy court seemed to view the relationship of the parties graphically as totally distinct from each other. (*See* Memorandum Opinion at 2). However, it is clear from the Findings of Fact that Bennett acted alone.

struct, equip, and furnish the hotel so that it could be opened as a first-class hotel. Memorandum Opinion at 4. Appellants contributed $3,292,137.50 to the partnership. (*See* Stipulation filed August 23, 1989, attached as *Appendix C*).

To the extent that funds were necessary to construct and equip the hotel beyond the $22,000,000, the general partner was required to contribute such amounts. (Ex. 2 at Art. 2.1(a)(6)). However, if the project were completed under budget, a distribution of up to $4,000,000 was available to Bennett. *Id.* at Art. 7.1.

The people working for Mariner Corporation (a corporation owned 100% by Bennett) understood that if there were savings on the project, those savings went directly to Archie Bennett, Jr. (Tr. at 27-28, 87-88). The bankruptcy court, based on the evidence, found the following facts:

1. Plaintiffs are and were at all relevant times in question, limited partners in a partnership known as Mariner Greenspoint, Ltd.

2. Mariner Interest No. 20, Ltd. is and was at all relevant times the general partner of Mariner Greenspoint, Ltd.

3. Bennett is and was at all relevant times the general partner of Mariner Interest No. 20, Ltd.

4. Bennett is a debtor in the bankruptcy case 388-37142-RCM-7 filed on or about November 23, 1988.

5. The partnership constructed and owned a Marriott hotel located near Greenspoint Mall at 255 Northbelt East, Houston, Harris County, Texas.

6. The partnership agreement is attached to the complaint as Exhibit A.

7. Plaintiffs invested the sums described in Exhibit B to the complaint.

8. Under the terms of the agreement, the general partner was charged with management of the partnership and had full, exclusive, and complete authority and discretion to manage, control and make all decisions affecting the purposes of the partnership, to take any action required to effectuate the purpose set forth in Article 1.6 of the agreement, and to exercise all rights and powers generally conferred or inferred by law with regard to such obligations.

9. The general partner was required to act in good faith in the performance of the obligations of the agreement.

10. The general partner was obligated under Article 2.1(a)(6) of the agreement to contribute cash to the extent necessary to pay all of the actual costs incurred to construct, equip, and furnish the hotel in such manner that it could be opened and operated as a first-class hotel.

11. Bennett was made aware of mildew problems at the Brookhollow Marriott, similar to those which plagued the Greenspoint Marriott.

12. The heating, ventilation, and air conditioning design of the Brookhollow Marriott was substantially the same as the Greenspoint Marriott.

13. Mariner and Bennett attempted to rectify the mildew problem by rebuilding those rooms which were damaged by mildrew, including the removal of all wall coverings, sheetrock, and fiberglass insulation and the reinstallation of such materials in an attempt to solve the problem.

14. Before taking any "savings" (Pl Ex. 2, ¶ 7.2, 2.1(a)(6)) allowed under the partnership

agreement, the general partner was required to provide all equipment to operate the hotel as a "first-class hotel."

15. Mariner Corporation, at all times relevant to this action, was owned 100% by Archie Bennett, Jr. Mariner Corporation, its officers and employees, acted on behalf of Mariner Interest No. 20, Ltd. and Archie Bennett, Jr. in carrying out the obligations of the general partner of Mariner/Greenspoint, Ltd.

16. The Greenspoint Marriott Hotel opened in January 1981.

17. Prior to the opening, Mariner Corporation was concerned about its loan arrangement, which was committed only until February 1981. If Mariner was unable to complete the construction and missed the opening, Mariner stood to lose an additional $1 million.

18. Eaves Construction Co., the general contractor ultimately awarded the construction contract for the Greenspoint Marriott Hotel, was one of the original bidders for the Greenspoint Marriott. All of the bids initially submitted to Mariner, including Eaves', were at least $1 million over the budget amount of $22 million.

19. Subsequently, after consultation with Mariner, Eaves dropped its bid price by $1 million and got the bid. However, Eaves was unable to obtain a bond. Bennett told Eaves it could have the job without a bond if it reduced its fee (the general contractor's fee) by one-half.

20. The general contractor's fee represents its profit on the job, assuming there are no construction savings.

21. Eaves was unable to obtain a bond because it had no prior history of constructing large projects and had no financial strength.

22. The reduction of the contractor's fee reduced the bid by an additional $250,000.

23. It was not normal to use a contractor that could not be bonded. Some Mariner personnel expressed concern to Bennett about Eaves' ability to run a business.

24. Mariner employees were aware that, if the project was completed under budget, the savings would be paid directly to Archie Bennett, Jr.

25. The hotel was built on a "fast track" system. This system involved developing plans to a certain point, and having subcontractors bid on the specifications without the benefit of actual drawings. This type of system accelerates completion of the project. Marriott had to approve all plans developed under the "fast track" system.

26. In August 1980, Marriott reluctantly granted approval of the heating, ventilation and air conditioning design for the Greenspoint Marriott Hotel because of the advanced stage of the construction. However, Marriott anticipated that the guest rooms would have a musty odor. Further, Marriott conditioned its approval upon Bennett accepting full responsibility for any reparations required by subsequent mildew damage. The design was not acceptable by Marriott design standards and would not be permitted in future hotels projects.

27. In late summer 1980, a mildew problem began to occur in the guest rooms of the Brookhollow Marriott Hotel, which was designed the same

as the Greenspoint Marriott. By November, mildew had occurred in 55 of 200 rooms checked at the Brookhollow Marriott.

28. At the time of the opening of the Greenspoint Marriott in January 1981, Archie Bennett, Jr. received a $1 million distribution. The $1 million was a result of constructing the Greenspoint Marriott Hotel for less than the budgeted $22 million.

29. Mildew began to occur in the guest rooms of the Greenspoint Marriott in April 1981. By July 1981, mildew had appeared in 169 of the 400 rooms at the Greenspoint Marriott. In April 1981, Marriott had determined that the "negative pressure" of the hotel contributed to the mildew problem.

30. "Negative pressure" in a building occurs when more air is exhausted from the building than is made up with conditioned air. The result is that warm, humid aid will be drawn into the building to equalize the pressure.

31. By June 1981, Mariner continued to identify the "negative pressure" in the Greenspoint Marriott as contributing to the mildew problem. Marriott requested that Mariner correct the problem.

32. By August 1981, 398 rooms in the Greenspoint Marriott had been damaged by mildew. Mariner was aware that the building exhausted between 19,400 cfm and 30,294 cfm more than was made up by conditioned air. Mariner requested that Eaves, the contractor, revinyl and resheetrock all of the rooms and correct the "negative pressure" problem so that the building would have a positive pressure. Eaves did

revinyl and resheetrock, but never solved the negative pressure problem.

33. Mariner and Bennett were informed in June 1981 that the "negative pressure" problem could have been resolved at a cost of between $125,000 and $175,000. At such time, legitimate business questions existed as to the complete cause of the mildew problem: who was responsible for it, and what was the most reasonable and economical method of attempting to cure same.

34. In the summer of 1982, after all of the rooms at the Greenspoint Marriott had been revinyled and resheetrocked, mildew again appeared in numerous guest rooms. It was noted by the manager of the hotel at that time that it was obvious that they would be revinyling rooms until everyone was "old and gray" unless the "negative pressure" problem was rectified.

35. In 1982, the rooms at the Greenspoint Marriott were again revinyled and resheetrocked. Additional modifications were also made to resolve the vapor barrier problems which had been found to exist. The interior faces of the wall vinyl in the guest rooms acted as vapor barriers. When a wall was cooled by air conditioning, the cooling effect caused moisture inside the wall to condense and saturate the sheetrock, thus permitting mildew to form and bleed through the vinyl wall coverings.

36. The revinyling, resheetrocking and other modifications made in 1982 were charged to the partnership earnings and paid for by the partnership. That is, the costs were charged, in part, to the limited partners. The total sum paid by the partnership for the second round of reconstruction totaled $192,915.

37. In 1983, the mildew reappeared in the rooms at the Greenspoint Marriott. However, the hotel also suffered damage as a result of Hurricane Alicia, and insurance proceeds were used to replace the vinyl and sheetrock a third time.

(Memorandum Opinion at 2-9).

In addition, the evidence supported the following findings proposed by Appellants, though not specifically found by the court:

1. Archie Bennett was made aware of the mildew problem at the Brookhollow Marriott, but did nothing prior to the opening of the Greenspoint Marriott to change or alter its design. By January 1981, 196 rooms at the Brookhollow Marriott had mildew. (Tr. 32, 33, 34; Ex. 7, 10).

2. Another contributing factor to the mildew problem was Mariner's utilization of General Electric Zone Line air conditioners, which were defectively designed and manufactured. The defective design and manufacturing of the Zone Line units caused excessive condensation accumulation in and around the walls and installation fittings by which the Zone Line units were incorporated into each room of the hotel. (Ex. 33, 34).

3. Today, the hotel still has a "negative pressure." (Tr. 409).

4. It was the responsibility of the general partner to build, construct and equip the hotel. Thus, it was the responsibility of the general partner to pay for all corrective construction to resolve the mildew problem. (Tr. 68-71, 193; Ex. 2).

5. The hotel leased various items of equipment, including a trash compactor, vans, outside signs, mobile beepers, trucks, security systems, copy machines, postage machines, communications

systems and PBX systems. All of these items of equipment could have been purchased by the general partner before the Greenspoint Marriott was completed and opened. Instead, the items were leased and charged to the partnership. (Tr. 51-52, 70-71, 159-63, 179-84, 314-15, 320-21; Ex. 36, 37, 38, 39, 40).

6. It was the obligation of the general partner to equip the establishment so that it could be run as a first-class hotel. All equipment rented by the partnership was necessary so that it could be operated as a first-class hotel. The general partner did not pay the lease costs of this equipment, but instead charged the costs to the partnership. The general partner would enter into lease agreements and charge the lease costs to the partnership rather than be responsible for those costs himself. The total rental charges from the inception of the partnership through 1987 was more than $887,000. (*Id.*)

The above facts, in addition to the testimony and exhibits introduced at trial, clearly show that:

1. The hotel had design problems which were known to Bennett in August 1980, prior to opening;
2. Nothing was done to alter or correct the problem;
3. Bennett did not provide all equipment necessary to open and operate the hotel;
4. Bennett did *not* "construct, furnish and equip" the hotel with the $22,000,000;
5. The partnership, not Bennett, paid the cost of equipment rental after opening;
6. Bennett withdrew $1,000,000 from partnership funds for himself upon the opening of the hotel; and

7. Repair costs for the mildew problem, the second time, were paid from partnership funds.

As the person in control, all of these were acts of self-dealing by Bennett. That is, every act or failure to act benefitted Bennett directly. Clearly, a defalcation by a fiduciary occurred. Based on the facts, the court found that a defalcation occurred upon the payment of mildew repairs with partnership funds and upon payment for certain leases by the partnership. These amounts totaled $904,204.00.

The bankruptcy court acknowledged that if Bennett were a fiduciary to the limited partners of M/G, then Bennett's debt to the limited partners would not be dischargeable under 11 U.S.C. § 523(a)(4). However, the bankruptcy court found that Bennett was not a fiduciary within the meaning of the bankruptcy code, stating:

> "No. 20 was the fiduciary of [M/G] and only it had an express, technical, pre-existing trust relationship with [M/G], even though Bennett was the managing partner of No. 20. However, Bennett's individual liability comes into effect only by reason of breach of No. 20, and under [the Texas Uniform Partnership Act] § 15 . . . . TUPA § 15 makes Bennett liable for No. 20 partnership "obligations," but does not create a fiduciary relationship between Bennett and Plaintiffs.

Memorandum Opinion at 19. The primary case relied upon by the court to support this holding was *In re Hurbace*, 61 B.R. 563 (Bankr. W.D. Tex. 1986). The court concluded that "for § 523(a)(4) purposes, the Plaintiffs must be the beneficiaries of a trust relationship of which Bennett, not No. 20, was the fiduciary." (Memorandum Opinion at 20).

The bankruptcy court then determined that if its decision were reversed on appeal, holding Bennett as a fiduciary to the limited partners of M/G, the proper measure

of damages would be actual damages, instead of full restitution of all capital contributions made by the limited partners. The court did acknowledge that two cases, *Crenshaw v. Swenson* and *Watson v. Limited Partners of WCKT, Ltd.*, held that full restitution was in order. However, the court found that if it were reversed on appeal, damages of $904,204.40, multiplied by Appellants' respective partnership interests, would constitute the amount of the non-dischargeable debt owed by Bennett to Appellants. (Memorandum Opinion at 35-39).

DISCUSSION

I. WHO WAS THE FIDUCIARY?

What is wrong with this picture:

> Jones and Smith are general partners of the JS Trust Company. Daddy Warbucks dies leaving $1,000,000 in trust for Little Orphan Annie, naming JS Trust Company as Trustee. Jones and Smith, tiring of the trust business, close the doors, split the $1,000,000 and each buy a house in Highland Park. Both file for Chapter 7, claiming the houses as homestead. Annie objects to discharge and is told she should look to JS Trust Company, her fiduciary.

That cannot be right! But according to the opinion below, that is what happens. Clearly, the holding is erroneous, as a matter of law.[2]

Here, the bankruptcy court found a fiduciary existed and that fiduciary, No. 20, committed a defalcation within the meaning of § 523(a)(4). (Memorandum Opinion at 19). Thus, if No. 20 were the debtor, it would not get a discharge.

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[2] Notably Judge McGuire had previously denied Bennett's Motion for Summary Judgment when confronted with the same issue. (Items 3, 6, 7 and 9 of Appellants' Designation of Record and Items 2 and 3 of Appellee's Designation of Additional Items to be Included in Record on Appeal).

Also, it is clear that an express trust did exist: the partnership agreement. (Ex. 2) This case does not involve a constructive trust where the very act of wrongdoing creates the "trust" relationship. *See Davis v. Aetna Acceptance Corp.*, 293 U.S. 328, 333, 55 S.Ct. 151, 154 (1934).

The bankruptcy court's holding, however, turns on its implicit finding that Bennett's liability "comes into effect only by reason of breach by No. 20." Memorandum Opinion at 19. Stated another way, when No. 20 stole the money, a constructive trust instantly resulted in favor of Plaintiffs with Bennett as the obligor, and thus, he is not a fiduciary within § 523(a)(4). To reach this conclusion, the court ignores both the specifics of the M G partnership agreement and partnership law.

A. *Partners Are Jointly and Severally Liable for Partnership Obligations*

As noted by the court below:

> All partners are jointly and severally liable for all debts and obligations of the partnership, including the obligations under Section 13 and 14.

Tex. Uniform Partnership Act, Art. 6132b § 15 (Vernon 1970) (Quoted in Memorandum Opinion at 18). The effect of this statute is that partners can be sued directly without the necessity of proceeding against the partnership or joining it in the suit. *Foster v. Daon Corp.*, 713 F.2d 148, 151 (5th Cir. 1983). In other words, if the partnership has the obligation, the individual general partner has the obligation. Thus, if No. 20 is a trustee of an express trust (general partner of a limited partnership), then, as a matter of law, all of its general partners are obligated as trustees.

Further, the bankruptcy court cited Sections 13 and 14 of the Texas Uniform Partership Act, but ignored the contents of those sections:

§ 13. Partnership Bound by Partner's Wrongful Act

Sec. 13. Where, by any wrongful act of omission of any partner acting in the ordinary course of the business of the partnership or with the authority of his co-partners, loss or injury is cause to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act.

§ 14. Partnership Bound by Partner's Breach of Trust

Sec. 14. The partnership is bound to make good the loss:

(a) Where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and

(b) Where the partnership in the course of its business receives money or property of a third person and the money or property so received is misapplied by any partner while it is in the custody of the partnership.

These obligations are *specifically* included as the joint and several obligations of each partner under Section 15. Therefore, each partner is personally obligated where the partnership receives money or property of a third person and misapplies it. Here, the creation of the M/G limited partnership with No. 20 as its general partner specifically created a technical trust, with Bennett having the obligations and liabilities of a trustee.

Without question, under the Uniform Partnership Act and the common law, partners are jointly and severally obligated for partnership obligations. *Smith v. Wayman*, 224 S.W.2d 211 (Tex. 1949). This includes contract obligations, *Rhodie v. Washington*, 641 S.W.2d 317, 320

(Tex. App.—El Paso 1982, writ ref'd n.r.e.) (general partner individually liable for debt of bankruptcy limited partnership); torts, *Kent v. National Supply of Texas,* 36 S.W.2d 811 (Tex. Civ. App.—Waco 1931, writ ref'd) (conversion); deceptive trade practices, *Foster v. Daon Corp., supra,* 713 F.2d at 151; and fiduciary duties, *Cook v. Brundidge, Fountain, Elliot and Churchill,* 533 S.W.2d 751 (Tex. 1976); *FDIC v. Braemoor Associates,* 686 F.2d 550, 556-558 (7th Cir. 1982).

In *Cook,* the client of a law firm sued the firm for breach of fiduciary duty and fraud resulting from the acts of one of the partners. Mr. Lyon, a partner in the firm, had convinced his client to invest in a company, where he was an officer and shareholder. This company then went bankrupt. The court relied on the provisions of the Texas Uniform Partnership Act quoted above, holding that if it were established that the funds were misapplied, and that Lyon was carrying on the business of the firm, then the liability of the firm would follow. *Id.* at 757-759.

The present case is analogous to *Cook.* Here, the court found No. 20 defalcated over $900,000. It is the same as saying Bennett defalcated these amounts; otherwise, the statutes quoted above are meaningless.

The creation of the express trust between Bennett and Appellants is amply demonstrated by *Crenshaw v. Swenson.* In that case, the limited partnership had as its general partner a general partnership known as Occidental Syndicated Investments. Occidental originally was comprised of three individuals, including Swenson. However, two members resigned leaving Crenshaw as the sole general partner of the general partner. Suit was brought against Swenson individually for breach of fiduciary duty. The trial court found that Swenson had transferred partnership property to a corporation controlled by her, and had deposited proceeds of a sale of partnership assets into the corporation's account. The trial court failed to find a breach of fiduciary duty. The appellate court reversed

and rendered on this point, holding that Swenson, the general partner of the general partner breached *her fiduciary duty to the limited partners* as a matter of law. *Id.* at 891.

The same is true here. Bennett and No. 20 cannot be separated by a nonexistent legal fiction.[3] The acts of Bennett are the acts of No. 20 and vice versa. Bennett is obligated as the general partner of M/G because he is the general partner of No. 20. He was a fiduciary to Plaintiffs under an express pre-existing trust relationship: the M/G partnership agreement.

B. *The Bankruptcy Court Ignored Specific Provisions of the Partnership Agreement*

The bankruptcy court ignored specific provisions of the partnership agreement and the fact that Bennett benefitted personally by the defalcations.

Article 10 of the Agreement prohibited Bennett from voluntarily withdrawing as the general partner of No. 20. Bennett further represented and warranted in that Agreement that, during the term of the Agreement, he would not alter his ownership of his general partnership interest in No. 20 except as otherwise provided in the Agreement. This unambiguous contractual provision, taken with Bennett's status as sole general partner, assured the limited partners that Bennett, and Bennett alone, would be in charge of the project. Whatever No. 20 did was ultimately a result fo Bennett's decision. Whatever benefit it derived went to Bennett. Indeed, as the court found, all savings on the project went directly to Bennett. Memorandum Opinion at 6.

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[3] The discussion in the Opinion regarding "piercing the entity of No. 20" is misplaced. (Memorandum Opinion at 15-17). At common law, a partnership is not a legal entity, but only a contractual status. *Kent v. National Supply Co., supra.* The Uniform Partnership Act does not alter this concept where individual liability is concerned. *See* §§ 13, 14, and 15, Art. 6132(b), *supra.*

Further, Under Section 12.5 of the Agreement, each limited partner appointed Bennett as his attorney to execute all documents on behalf of M/G. Accordingly, this court need not go beyond the terms of the Agreement itself to find that Bennett owed a direct fiduciary duty to Appellants, and that this fiduciary relationship, under Texas law, rose to the level of the fiduciary duty a trustee owes to its beneficiaries.

C. *Bennett Took the Money*

The holding by the court ignores reality, elevating form over substance. Bennett was the human being who controlled the actions of No. 20 and M/G. No other person was available. The only person who could and did decide to: (1) do nothing to solve the negative pressure problem, (2) do nothing to alter the design of the hotel when warned by Marriott, (3) fail to furnish equipment, but charge the partnership for equipment rental, (4) take $1,000,000 as "savings" despite the above and (5) charge the partnership for the cost of mildew repairs.

Bennett, not No. 20, got the $1,000,000 distribution. This was an additional defalcation not found by the court below. Bennett intentionally arranged for the employment of an unbondable contractor so that the Greenspoint Marriott project could be completed under budget by $1,000,000. Bennett stacked the cards so that he would receive the distribution. He ignored mistakes inherent in the design of the hotel. He installed defective air conditioning equipment. (Ex. 33, 34). Bennett did not satisfy his obligation to the limited partners to deliver a first-class hotel and, yet, still took $1,000,000 out of partnership funds, for himself.

By applying settled principles of law established above, this court should find that Bennett committed an additional defalcation when he arranged for the distribution of the $1,000,000 to himself. The court below found that No. 20 defalcated over $900,000 which, based on the

record and the law, was clearly the act of Bennett. However, the $1,000,000 distribution in 1981 should never have been made and it is an additional defalcation to be added to the amounts found by the court below.

II. THE BANKRUPTCY COURT'S CONTINGENT CALCULATIONS OF DAMAGES ARE IN ERROR

Nearly half of the bankruptcy court's Memorandum Opinion anticipates that its decision will be reversed upon appeal. To that end, the bankruptcy court offered an extensive analysis of the leases entered into by No. 20, describing which leases constituted defalcations not dischargeable under § 523(a)(4).[4] If this court reverses the bankruptcy court, as it should, then the determination of the bankruptcy court that these leases constituted defalcations is controlling, because these findings have not challenged by Bennett. The question at this point is, however, whether the bankruptcy court should have addressed the measure of damages issue at all. For the following reasons, the bankruptcy court incorrectly concluded that Appellants (Plaintiffs below) were entitled only to recover actual damages and not full restitution.

A. *Equitable Restitution Is the Appropriate Remedy*

The bankruptcy court was troubled with the possibility that full restitution should be awarded under Texas law "regardless of whether the defalcation was for $10.00 or for $10 million." Initially, it should be noted that this concern is not one which the bankruptcy court or this

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[4] It should be noted that the mere fact that equipment necessary to open and operate the hotel was not provided by Bennett is a defalcation. The equipment that was leased could have been bought. (Tr. 51-52, 70-71, 159-63, 314-315, 320-21; Ex. 36). By not buying the equipment, a distribution of $1,000,000 ws available and made to Bennett. (Memorandum Opinion at 6). Bennett did not pay the rental expenses; rather, they were paid by the partnership. Total rental expense was $887,000 (Ex. 36-40). The court found $832,204 as being the subject of a defalcation. (Memorandum Opinion at 31).

court need address since more than $10.00 was defalcated. In fact, the bankruptcy court acknowledged that over $900,000 was defalcated. Moreover, this $900,000 does not include the $1,000,000 Bennett defalcated when he distributed that amount to himself upon the opening of the hotel.

The bankruptcy court also found that despite the existence of controlling authority, *Crenshaw v. Swenson* and *Watson v. Limited Partners of WCKT, Ltd.*, it would not award full restitution as damages to the limited partners of M/G. The court noted:

> The damage issue is straightforward and would not be complicated if it were not for the seminal case of *Watson* . . . . There, the Austin Court of Appeals, in awarding restitution, held that it was not necessary that there be proximate cause between the breach and the damages awarded because the fiduciary breached his duties, and, thus, the limited partners were entitled to restitution of their entire investment as a matter of law. [citations omitted] In *Crenshaw, supra* at 891, the court stated, "courts are ill-equipped to discern the extent a conflict of interest *may* have affected the outcome of any given transaction . . . .
>
> —The cases cited in *Watson* only held that, if a fiduciary breaches his duties, he forfeits his *right to compensation* as a matter of law, without regard to whether there is proximate cause between the breach and the damages. Those cases do not hold that the injured beneficiaries of the fiduciary relationship are entitled to *restitution of their entire investment*, without regard to proximate cause.

(Memorandum Opinion at 36-37 (emphasis in original)).

Both the reasoning and conclusion of the bankruptcy court are flawed. First, the bankruptcy court's decision in this case is directly contrary to the settled rulings in

Crensharw and in *Watson*. The bankruptcy court is only supposed to apply Texas law, not decide what it should be. *Cf. Butner v. U.S.*, 440 U.S. 48 (1979).

Second, the bankruptcy court's strained construction of the opinion in *Watson* ignores the holding of the court there. The *Watson* court relied on prior Texas Supreme Court precedent: *Kinzbach Tool Co., Inc. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942).

> It is beside the point for either Turner or Corbett to say that Kinzbach suffered no damages because it received full value for what it has paid and agreed to pay. A fiduciary cannot say to the one whom he bears such relationship: You have sustained no loss by my misconduct in receiving a commission from a party opposite to you, and therefore you are without remedy. *It would be a dangerous precedent for us to say that unless some affirmative loss can be shown, the person who has violated his fiduciary relationship with another may hold on to any secret gain or benefit he may have thereby acquired.* It is the law that in such instances if the fiduciary takes any gift, gratuity, or benefit in violation of his duty, or acquires any interest adverse to his principle, without a full disclosure, it is a betrayal of his trust and a breach of confidence, *and he must account to his principal for all he has received.*

Kinzbach, 160 S.W. at 514 (emphasis added; citations omitted).

The bankruptcy court noted that in some instances a fiduciary must forfeit his right to compensation. *Citing Kinzbach Tool, supra; Anderson v. Griffith*, 501 S.W.2d 695 (Tex. Civ. App.—Fort Worth 1973, writ ref'd n.r.e.) and *Russell v. Truitt*, 5321 S.W.2d 948 (Tex. Civ. App. —Fort Worth 1977, writ ref'd n.r.e.). The court noted that those cases "do not hold that injured beneficiaries of the fiduciary relationship are entitled to restitution of their entire investment. . . . Opinion at 36-37. This should

come as no surprise. The cases cited did not involve investments or the misuse of trust funds held by a trustee. They all involved commissions wrongfull obtained by agents. The agents had to account for all that they received. So does Bennett.

The facts found by the court below demonstrate clearly that in this case there was a defalcation by a fiduciary through acts of self dealing. There is no requirement of proximate cause. Beneficiaries of a trust may attack self dealing transactions by a trustee even if they suffer no damages and even if the trustee acts in good faith. *Slay v. Burnett Trust,* 143 Tex. 621, 187 S.W.2d 377, 389 (1945); *Harvey v. Casbeer,* 531 S.W.2d 206 (Tex. Civ. App.—Tyler 1975, no writ). Upon a finding of breach, the trustee must account for all he has received. *Watson, supra,* 570 S.W.2d at 182.

In *Watson,* the court held that restitution was a recognized measure of recovery and that a showing of proximate cause of actual loss was not required. 570 S.W.2d at 182; *Russel v. Truitt,* 554 S.W.2d 948 (Tex. Civ. App. —Fort Worth 1977, writ ref'd n.r.e.). The court noted that suits such as this are to recover money had and received, and the money received by the general partner as contributions by the limited partners were due as restitution. *Id.*

The bankruptcy court chose to ignore *Crenshaw v. Swenson, supra,* because it cited *Watson* for a different proposition. Memorandum Opinion at 37 n.2. However, the court in *Crenshaw* clearly held that no damages need be shown and that, upon a showing of a breach of fiduciary duty, the limited partners were entitled to equitable restitution of their partnership contribution. *Id.* 611 S.W.2d at 891. It should be noted again that Swenson was the general partner of the general partner of the limited partnership.

Third, the bankruptcy court's notation that "[a] plaintiff must introduce sufficient evidence to provide a trier

of fact with an intelligent means in determining an appropriate damage award without speculation or conjecture," Memorandum Opinion at 38, is an argument which favors *Appellants*, not Bennett. Speculation or conjecture is far greater with respect to damages when a court reviews several leases and engages in a complicated analysis of actual damages, instead of simply awarding full restitution to the wronged parties. In this case, the parties stipulated the amounts of Appellants' investments in the partnership. (*See* Stipulation filed filed August 23, 1989, at *Appendix A*). The contribution by the limited partners are certain and easier to quantify when compared to an analysis of which leases were proper and which were not. The bankruptcy court should not have substituted its decision in the face of such overwhelming Texas law to the contrary.

B. *The Proceeding Involved Only the Dischargeability of Bennett's Debt*

The bankruptcy court, in calculating actual damages, assumed its proper role was *sua sponte* to calculate damages upon the determination that a debt was nondischargeable. This practice of calculating damages, however, was rendered obsolete when the Bankruptcy Code was enacted in 1978. Section 17c(3) of the old Bankruptcy Act provided that if a debt were found to be nondischargeable, the bankruptcy court was to "determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof." This language was omitted from Section 523 of the Bankruptcy Code, the successor statute to Section 17c(3) of the old Bankruptcy Act. Now the proper procedure for determining claims is the claims objection procedure, found at 11 U.S.C. § 502 and Bankruptcy Rules 3001, *et seq.* Depending upon the context of the claims procedure, an objection to claim will either be a contested matter or an adversary proceeding pursuant to Bankruptcy Rules 7001 *et seq.* and 9014. *Section 523 is silent as to the liquidation of nondischargeable debts.*

The few courts which have adhered to the procedure provided under the old Bankruptcy Act cite as their authority the provisions and cases under the old Bankruptcy Act. *See In re Lorren*, 45 B.R. 584, 589 (Bankr. N.D. Ala. 1984); *In re Cope*, 35 B.R. 287, 288 (Bankr. W.D. Mich. 1983). These cases, however, are incorrect under the present Bankruptcy Code's operation.

A number of courts which have interpreted this question under the Bankruptcy Code have ruled precisely as Appellants in this case contend. The bankruptcy court in *In re Stelweck*, 86 B.R. 833, 844-45 (Bankr. E.D. Pa. 1988), *aff'd*, 108 B.R. 488 (E.D. Pa. 1989), stated:

> We disagree with the assertion that liquidation of a debt has any bearing on whether it is dischargeable or not. The role of the bankruptcy court is not to determine the extent of non-dischargeable debts . . . but to determine whether debts are dischargeable. . . .
>
> We acknowledge that Section 17c(3) of the predecessor Bankruptcy Act provided that "if any debt is determined to be non-dischargeable, [the court] shall determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof." However, without any apparent explanation in the legislative history, this provision was omitted from § 523 of the Bankruptcy Code. We are most reluctant to read such an omitted provision back into the Code.

Id. at 844.

Other courts have ruled in the same manner as did the court in *Stelweck*. *See In re Crist*, 85 B.R. 807, 816 (Bankr. N.D. Iowa 1988):

> Finally, the Court herein makes no determination of the actual amount of taxes that are non-dischargeable. [The] IRS has urged the Court to accept the amount stated in the Notice of Deficiencies . . . .

> Any presumption that the amounts in the Notices of Deficiencies are correct . . . or any presumption arising under Bankr. R. 3001(b) are therefore, more appropriately recognized by the Court in a subsequent adversary proceeding, if necessary, in which the validity of [the] IRS' claim is adjudicated.

In re Lambert, 59 B.R. 503, 507 (Bankr. M.D. Ala. 1986):

> As to the court's erring and failing to set damages to this case, we conclude that it is not incumbent on the court in every instance to assess the amount of the debt which is determined to be non-dischargeable. That matter is already an issue, and the only matter before the court is the dischargeability of the debt, a matter exclusively within the jurisdiction of this court, then it is appropriate to leave the liquidation of damages to another court.

It follows then that the proper interpretation of the interaction between adversary proceedings challenging the dischargeability of debts and adversary proceedings challenging the amount of claims against the debtor is not as the bankruptcy court assumed it is. Under the Bankruptcy Code, when a finding of non-dischargeability is made, the creditor can either liqudate the amount of the debt in the bankruptcy court under 11 U.S.C. § 502 and the applicable bankruptcy rules, or it can do so in state court. By filing a proof of claim, the creditor will receive what it can from the bankruptcy estate, with the balance owing and payable from the debtor's post-discharge earnings. If a proof of claim is not filed, however, the creditor can seek only post-discharge earnings; it forfeits the right to the participation of funds from the bankruptcy estate.

In this case, Appellants, in fact, did file proofs of claim. To date, no party has challenged these proofs of claim. Thus, there should have been no controversy regarding the amounts asserted by Appellants with respect to damages in this case. If a controversy existed, Bennett or the

trustee should have filed the appropriate adversary proceeding. The issue should not have been raised by the bankruptcy court at this time.

Moreover, the exhibits offered by both parties in this case were directed only to the question of the dischargeability of Bennett's debt, not the amount of damages. In fact, Appellants (Plaintiffs below) operated under the assumption throughout this case that the question of damages was not at issue, since that question would have been determined under 11 U.S.C. § 502 and Bankruptcy R. 3001 *et seq.*

Indeed, the amount of damages at stake was being disputed in a state court action brought by the plaintiffs against Bennett prior to the institution of Bennett's bankruptcy case. The bankruptcy court denied plaintiff's motion to consolidate the state court case with the adversary proceeding to challenge the dischargeability of Bennett's debt to the plaintiffs. By denying this motion to consolidate, and by determining damage issues without notice or any basis under the Bankruptcy Code, the bankruptcy court effectively denied the limited partners of M/G an opportunity to offer their affirmative evidence of damages. The bankruptcy court ruled on damages without evidence available from the state court action, and without having the appropriate evidence presented in adversary proceeding. For these reasons, this court should, at the very least, remand the matter back to the bankruptcy court for a proper determination of damages.

CONCLUSION

For all of the reasons specified above, Appellants respectfully request that this court reverse the February 20, 1990 Memorandum Opinion and Final Judgment of the bankruptcy court in all respects.

Respectfully submitted,

LIDDELL, SAPP, ZIVLEY, HILL & LABOON

By: /s/ D. Mitchell McFarland

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Attorneys in Charge for Appellants, LSP Investment Partnership, et al.

IN THE DISTRICT COURT OF
HARRIS COUNTY, TEXAS
234TH JUDICIAL DISTRICT

No. 84-69448

LSP INVESTMENT PARTNERSHIP, *et al.*

VS.

MARINER INTEREST NO. 20, LTD. AND
ARCHIE BENNETT, JR.

PLAINTIFFS' SECOND AMENDED PETITION

[Filed February 9, 1988]

TO THE HONORABLE JUDGE OF SAID COURT:

COME NOW LSP Investment Partnership, a Texas partnership, and Charles Sapp, Howard Boyd, R. Bruce LaBoon, Thomas Reidy, H. Michael Tyson, John C. Nabors, George Carameros, Willis Witt, Walter P. Zivley, Fred E. Croshaw (as agent for Croshaw Investment Partnership), W. Robert Brown, Frank A. Liddell, Jr. (as agent for Obie & Co.), Carl Galloway, Robert B. Wilkins, Edward Earle, Don C. Quast and Joe E. McLemore, all being individuals who reside in Houston, Harris County, Texas, complaining of Mariner Interest No. 20, Ltd., a Texas limited partnership, and Archie Bennett, Jr., its general partner, and for cause of action would respectfully show the following:

1.

Mariner Interest No. 20, Ltd. and Archie Bennett, Jr. have appeared and answered herein and no service is necessary.

2.

Defendant Mariner Interest No. 20, Ltd. ("Mariner") is the general partner of Mariner Greenspoint, Ltd., a Texas limited partnership (the "Partnership"). Plaintiffs herein are some of the limited partners in the Partnership. Defendant Archie Bennett, Jr. is the general partner of Mariner. A true and correct copy of the Mariner Greenspoint, Ltd. partnership agreement is attached hereto as Exhibit "A" and incorporated by reference herein. Mariner Greenspoint, Ltd. owned and operated the Marriott Hotel located near Greenspoint Mall at 255 North Belt East, Houston, Harris County, Texas 77060. Such hotel was managed by Marriott Corporation under the terms of a management agreement.

3.

Pursuant to the terms of the limited partnership agreement (the "Agreement"), Mariner and Bennett (the general partner of Mariner) as the general partner under the Agreement are charged with the management of the Partnership and owe to their limited partners a fiduciary obligation of utmost good faith. Specifically, under Article 4, the general partner has full, exclusive and complete authority and discretion to manage and control and make all decisions effecting the Partnership business, full authority to effectuate the purposes of the Partnership and take any action required to effectuate the purposes set forth in Article 1.8 of the Agreement, and full power to exercise all rights and powers generally inferred or conferred by law in connection with such obligations. However, these powers are specifically limited under Article 4.3 so that the general partner is required to manage the Partnership affairs in a prudent and businesslike manner and in accordance with good commercial practice. Further, the general partner is required to act in good faith and in the best interest of the partners in the performance of the obligations under the Agreement.

4.

Included in the obligations of the general partner under the Agreement was the obligation under Article 2.1(a)(6) to contribute cash to the extent necessary to pay all of the actual costs incurred to construct, equip and furnish the hotel in such a manner that it could be opened and operated as a first-class hotel. Further, under Article 9, the general partner warranted and represented that the hotel and related improvements would be completed substantially in accordance with the plans and specifications provided by the general partner to construct, equip and furnish the hotel as a first-class hotel. The Agreement allowed Mariner, as a general partner, the benefit, dollar for dollar, to the extent that the actual project cost was under budget.

5.

Mariner and Bennett breached their obligations under the Partnership Agreement in that they have not constructed and maintained the hotel as a "first-class" hotel. Specifically, the air conditioning and ventilation systems of the hotel are defectively designed. Because of the use of a substandard design, low quality, defective equipment and materials, and poor workmanship in the construction of the hotel, Mariner and Bennett benefitted to the extent of $1,000,000.00 because of cost savings during the construction. (*See* Article 7.1 of Exhibit "A.")

6.

In particular, the air conditioning and ventilation systems of the hotel are defectively designed and include the installation of defective products. The defective design has resulted in an excessive amount of mildew within the hotel, as well as a negative pressure resulting in moisture-laden outdoor air being pulled directly into the guest room floors. As a result of this defective design and the inability of Mariner and Bennett to solve these problems, the value of the hotel has diminished and consequently the value of

Plaintiffs' interest in the Partnership has diminished. Further, the problem has caused the hotel to lose profits and has injured business relations. To such extent, Plaintiffs have been damaged in an amount which exceeds the minimum jurisdictional limits of this Court.

7.

Further, as stated, the general partner incorporated defective products into the construction of the hotel. Mariner installed General Electric Long-Line Through-Wall air conditioning units in the hotel. These units are defectively designed and manufactured. The defective design and manufacture of these units causes excessive condensation accumulation in and around the wall and installation fitting where the units are incorporated into the rooms of the hotel. Specifically, the units are designed in such a manner that the air is discharged directly toward the wall into which the unit is placed thereby causing an excessive buildup of moisture. As a result of the installation of these defective products, the value of the hotel has been diminished and consequently the value of Plaintiffs' interest in the partnership has diminished. Further, the problem has caused the hotel to lose profits and has injured business relations. Plaintiffs have been damaged in an amount that exceeds the jurisdictional limits of this Court.

8.

Pleading further, Plaintiffs would show that the acts and omissions of Defendants Mariner and Bennett are the result of their negligence in carrying out their duties as general partner. Such negligence is the cause of the conditions which are now present at the hotel. As a direct proximate result of the negligence of Defendants, Plaintiffs have been damaged in an amount which exceeds the minimum jurisdictional limits of this Court.

9.

Mariner and Bennett have attempted to rectify the mildew problem by rebuilding those rooms which have been damaged, including the removal of all wallcoverings, sheetrock and fiberglass insulation and the reinstallation of such materials in an attempt to solve the problem. Under the terms of the Partnership Agreement, the general partner is responsible for providing all costs to construct a first-class hotel. Included within these obligations would be the obligation of the general partner to rectify the mildew problem. Defendants Mariner and Bennett have breached the Agreement in that, rather than use their funds to pay for the costs of repair and reconstruction of the damage as a result of the design defect, they have, instead, used Partnership operating funds. Such action constitutes a breach of Article 5 of the Partnership Agreement. As a result of such breach, Plaintiffs have been damaged in an amount that exceeds the minimum jurisdictional limits of this Court.

10.

Pleading further, Mariner and Bennett, as general partner, were required to provide all equipment to operate the hotel. Instead of providing the equipment as required by the Agreement, they have rented equipment and paid for the rentals out of Partnership operating funds. Such action constitutes a breach of the Partnership Agreement and Plaintiffs have been damaged by such breach in an amount that exceeds the minimum jurisdictional limits of this Court.

11.

The actions of Mariner and Bennett are in breach of the Partnership Agreement and are in conflict with the representations and warranties made by them under that Agreement. Under Article 9, the general partner is required, upon request, to refund the entire sum of all con-

tributions and loans made by any limited partner that makes such request. Demand has been made, and the general partner has not complied. Plaintiffs pray for specific performance of this requirement, or, in the alternative, damages in excess of the minimum jurisdictional limits of this Court.

12.

The actions of Mariner and Bennett as described above are in breach of their fiduciary obligation to Plaintiffs. Plaintiffs are entitled to restitution of their entire investment, including all capital contributions and loans together with interest at the highest rate. Such sums greatly exceed the minimum jurisdictional limits of this Court.

13.

The actions of Mariner and Bennett as described above were in bad faith and constitute gross negligence for which Plaintiffs are entitled to damages, as well as restitution of their investment.

14.

Plaintiffs are entitled to exemplary damages in an amount equal to three times actual damages.

15.

Plaintiffs have retained the undersigned attorneys to represent them in this action. Plaintiffs are entitled to recover attorneys' fees. Such attorneys' fees exceed the minimum jurisdictional limits of this Court.

WHEREFORE, PREMISES CONSIDERED, Plaintiffs pray that Plaintiffs recover damages as recited above in excess of the minimum jurisdictional limits of this Court, attorneys' fees, prejudgment and postjudgment interest at the maximum legal rate, a decree of specific performance compelling Mariner and Bennett to refund to each Plaintiff the sum of all contributions and loans to

the Partnership, and all costs incurred herein and for such other and further relief as may be appropriate in the premises.

Respectfully submitted,

LIDDELL, SAPP, ZIVLEY
& HILL

By: /s/ D. Mitchell McFarland
D. MITCHELL MCFARLAND
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Attorneys for Plaintiffs LSP
Investment Partnership,
et al.

AMENDED AND RESTATED CERTIFICATE AND AGREEMENT OF LIMITED PARTNERSHIP OF MARINER/GREENSPOINT, LTD.

(A Texas Limited Partnership)

THE INTERESTS EVIDENCED BY THIS AGREEMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, HAVE BEEN TAKEN FOR INVESTMENT, AND MAY NOT BE SOLD OR OFFERED FOR SALE UNLESS A REGISTRATION STATEMENT UNDER THE FEDERAL SECURITIES ACT OF 1933, AS AMENDED, WITH RESPECT TO SUCH INTERESTS IS THEN IN EFFECT, OR AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF SUCH ACT IS THEN, IN FACT, APPLICABLE TO SUCH OFFER OR SALE.

THIS AGREEMENT (the "Agreement") is made and entered into as of the 1st day of March, 1980, by and between Mariner Interests No. 20, Ltd., a Texas limited partnership, hereinafter called the "General Partner", and those persons whose names are subscribed at the end hereof as limited partners, hereinafter collectively called the "Limited Partners", together herein the "Partners".

WITNESSETH:

WHEREAS, Mariner/Greenspoint, Ltd. (the "Partnership"), a Texas limited partnership, was formed pursuant to the Certificate and Agreement of Limited Partnership of Mariner/Greenspoint, Ltd. (the "Original Agreement") dated November 28, 1979; and

WHEREAS, it is now desired that the Original Agreement be amended in certain respects, all as hereinafter set forth; and

WHEREAS, the initial Limited Partner, Archie Bennett, Jr., Trustee, withdraws as to his Limited Partnership Interest upon execution hereof by the new Limited Partners;

NOW, THEREFORE, the undersigned hereby agree to continue the Partnership, to amend the Original Agreement, and for convenience to restate the Original Agreement, as so amended, in its entirety as set forth hereinbelow:

Article I.

GENERAL

1.1 *Name.* The name of the Partnership shall be MARINER/GREENSPOINT, LTD.

1.2 *Place.* The principal place of business of the Partnership shall be 1700 West Loop South, Suite 800, Houston, Texas, 77027, or at such other places in the State of Texas as the General Partner may from time to time designate after written notice thereof to the Limited Partners.

1.3 *Classification of Limited Partners.* There shall be two (2) classes of Limited Partners, which classes shall be called and are hereby designated as the "Class A Limited Partners" and the "Class B Limited Partners". The Class A Limited Partners and the Class B Limited Partners shall be those persons or entities named and identified as such at the end of this Agreement. There shall be no distinction between the Class A and the Class B Limited Partners except as set forth in this Agreement.

1.4 *Organizational Matters.* The Partners immediately shall execute all such certificates (including, without limitation, the Certificate of Limited Partnership required by Section 3 of the Texas Uniform Limited Partnership Act) and other documents, and the General Partner shall make such filings and records, and perform such acts as

shall constitute compliance with all requirements for the formation and operation of a limited partnership under the laws of the State of Texas.

1.5 *Term.* The Partnership commenced on the date that the Certificate of Limited Partnership was filed with the Secretary of the State of Texas and shall continue until December 31, 2029, unless sooner terminated as hereinafter set forth.

1.6 *Purposes and Authority.* The specific business and purpose of the Partnership is to acquire, own, hold, develop and operate a hotel consisting initially of approximately four hundred (400) rooms and any expansion thereof and related improvements (said hotel and improvements being herein collectively referred to as the "Hotel") located on the property described on Exhibit "A" (the "Property") and in addition thereto the Partnership is formed for the purposes of and shall have authority to:

(a) Maintain and operate buildings or improvements upon real estate owned, leased or held by the Partnership, and in connection therewith, but without limiting the generality thereof, to design, lay out, develop, construct, remove, make additions to, or otherwise engage in any work upon the Hotel.

(b) Purchase, receive, lease or otherwise acquire, own, hold, improve, use or otherwise deal in and with personal property, or any interest therein, wherever situated, in connection with the business of the Partnership.

(c) Enter into agreements and business associations of every kind, make, perform, and carry out contracts of every kind for any lawful purpose pertaining to the business or any property of the Partnership, or in any manner incident thereto, as principal, agent, nominee or otherwise.

(d) Mortgage by Deed of Trust, Security Agreement, or otherwise, pledge, hypothecate or otherwise

create liens upon any part or all of the property of the Partnership, real, personal, or mixed.

(e) Borrow money for any of the Partnership purposes, and, in that connection, to execute and deliver such documents as may be necessary and incident to such borrowing, provided, however, that the indebtedness referred to in Section 7.1(a)(1) shall be undertaken on a non-recourse basis, providing that neither the Partnership nor any of the Partners shall have personal liability with respect to such indebtedness.

(f) Conduct and perform any and all other business activities necessary and proper in connection with the operation and maintenance of the Hotel, and its related facilities and properties, or incidental to or in connection with the foregoing, provided, however, that without the consent of Limited Partners owning more than fifty-one percent (51%) of the Partnership Interests of the Limited Partners, the Partnership shall not engage in any business other that the business of owning, holding, maintaining and operating the Hotel and related improvements.

Article 2.

CAPITAL CONTRIBUTIONS OF GENERAL AND LIMITED PARTNERS

2.1 *Initial Contributions.* Each of the Partners shall be obligated in a manner satisfactory to the General Partner to contribute to the capital of the Partnership the amount set forth opposite his name in the column entitled "Contribution" on the signature page of this Agreement. The percentage interest ("Percentage Interest") of each Partner in the Partnership shall be the percentage set forth opposite the name of each Partner in the column entitled "Initial Percentage Interest" on the signature page of this Agreement, adjusted as provided herein for Per-

centage Interests transferred, issued or redeemed pursuant hereto. The term "Partnership Interest" shall include all rights, benefits, duties, and obligations of a General or Limited Partner under the Texas Uniform Limited Partnership Act or this Agreement.

(a) *Supplementary Contributions by General Partners:* In addition to the other contributions required of the General Partner hereunder, the General Partner has contributed or shall contribute to the Partnership the following property:

(1) All rights of the borrower under a commitment for a permanent loan (the "Permanent Loan") in the amount of $18,000,000.00 to be secured by the Property, the Hotel and related improvements, said commitment for permanent loan being evidenced by a Permanent Loan Commitment from Connecticut General Life Insurance Company (herein referred to as the "Permanent Loan Commitment"), a copy of which is attached hereto as Exhibit "B". Neither the Partnership nor any Partner shall have any personal liability with respect to the Permanent Loan.

(2) All rights of the borrower under a commitment for an interim loan (the "Interim Loan") from Connecticut General Life Insurance Company in the amount of $18,000,000.00 (herein referred to as the "Interim Loan Commitment"), a copy of which is attached hereto as Exhibit "C", secured by the Property and improvements related thereto.

(3) The Property, including all improvements thereon, subject to the lien for the purchase price thereof plus interest. Said Property has been transferred to the Partnership by general warranty deed, a copy of which is attached

hereto as Exhibit "D", containing only those exceptions to title (the "Exceptions") which are set forth on Exhibit "A" attached thereto. In addition to the Exceptions, the Property is subject only to the lien securing payment of the Interim Loan.

(4) All rights of Owner pursuant to the Houston Airport Management Agreement dated September 4, 1979, (herein referred to as the "Marriott Management Agreement") and attached hereto as Exhibit "E", providing for the operation of the Hotel.

(5) Assignment of all other assignable documents and insurance owned by the General Partner necessary for the construction, operation or ownership of the Hotel, including, but not limited, to a valid building permit, casualty insurance policies, title insurance policy, survey and other work products.

The Partnership shall assume all obligations under the aforesaid agreements subject to any provisions thereof limiting personal liability, whether accruing prior to or after the date hereof.

(6) Cash to the extent that all of the actual costs incurred, including "soft cost" items (which shall include, but not be limited to, loan fees, legal and accounting fees, premiums and other costs for title insurance binders and policies, closing costs, taxes, interest, costs of acquiring and installing furniture, fixtures and equipment in the Hotel, landscaping costs, preopening expenses, and amounts payable for government permits), to construct, equip and furnish the Hotel (not including any additions thereto) in such a manner that it can be opened

and operated at a first-class hotel in accordance with the provisions of the Marriott Management Agreement, shall in the aggregate exceed Twenty-Two Million Dollars ($22,000,000.00).

(7) Non-interest bearing loans in an amount not to exceed a maximum of One Million Five Hundred Thousand Dollars ($1,500,000.00) at any time outstanding unless such amount is increased in accordance with Section 2.1(b).

The General Partner hereby grants to the Limited Partners a security interest in its Partnership Interest in order to secure its obligations pursuant to items (6) and (7) above. Upon the failure of the General Partner to provide such funds pursuant to items (6) and (7), the Limited Partners may foreclose upon the Partnership Interest, or any portion thereof, of the General Partner necessary to satisfy such obligations under the provisions of the Uniform Commercial Code in effect in the State of Texas. In order to perfect such security interest, the General Partner hereby agrees to execute a financing statement evidencing this grant of a security interest.

Contribution of those items listed at items (1) through (5) above has been or will be made within thirty (30 days) from the date hereof; provided, however, that in the event of failure to make any of such contributions required by items (1) through (5) by the General Partner, no Partner shall have any liability hereunder to make any contribution to the Partnership, and this Partnership shall be dissolved. In the event of dissolution pursuant to this provision only, any and all Partners' contributions previously made shall be returned to them in full and the General Partner shall have no further liability to any Partner. All other expenses incurred by or with respect to this Partnership prior, to such dissolution shall be borne and paid by the General Partner.

Notwithstanding anything in this Agreement to the contrary, if a creditor makes a non-recourse loan to the Part-

nership, in no event shall such creditor have or acquire at any time as a result of making such loan, any direct or indirect interest in the profits, capital, or property of the Partnership other than as a secured creditor.

(b) *Contributions by Limited Partners*: The Limited Partners shall contribute the following to the Partnership:

(1) Provided that those items listed as items (1) through (5) of Section 2.1(a) hereof have been contributed to the Partnership, within fifteen (15) days following receipt of a certificate from the General Partner verifying that to his knowledge there is no material default in the Interim Loan, the Permanent Loan Commitment, or the Marriott Management Agreement and that Fifteen Million Dollars ($15,000,000.00) or more of the Interim Loan has been funded to finance budgeted costs, including soft costs of construction of the Hotel, but in no event prior to July 15, 1980, the Limited Partners shall contribute pro rata in accordance with their respective Percentage Interests, cash in the aggregate amount of four million dollars ($4,000,000.00), such funds to be used to pay the budgeted costs of construction of the Hotel and related improvements or be paid to the General Partner as hereinafter set forth.

(2) Notwithstanding the provisions of the preceding paragraph (1), so long as there is no material default in the Interim Loan, the Permanent Loan Commitment, or the Marriott Management Agreement, in the event that prior to the completion of the Hotel, Connecticut General Life Insurance Company ("Connecticut General") should for any reason require any Partner or the Partnership to contribute funds into the Partnership, the Limited Partners hereby agree to provide Connecticut General with letters of credit issued by banks and upon terms acceptable to Connecticut General in the amount of the unpaid portion of the Limited Partners' obligations under Section (b)(1) above.

(3) Notwithstanding anything contained in this Agreement to the contrary, so long as there is no material default in the Interim Loan, the Permanent Loan Commitment, or the Marriott Management Agreement, the Limited Partners shall in no event make the contributions required by them in Section (b)(1) above later than forty-five (45) days prior to the Completion of Construction of the Hotel. For purposes of this paragraph, the Completion of Construction of the Hotel shall be a date upon which the Hotel shall be substantially completed and certified to in writing by the general contractor for the project and the General Partner. It is realized by the Limited Partners that this date will be an estimate on the part of the general contractor and the General Partner, but upon receipt by them of a certificate signed by the general contractor of the project and the General Partner stating that the Hotel will be completed in forty-five (45) days, they shall within fifteen (15) days of receipt of such letter make on a pro rata basis, their Four Million Dollar ($4,000,000.00) contribution, to the extent that such contribution has not already been made.

(4) During the term of this Agreement, provided that those items listed as items (1) through (5) and item (7) of Section 2.1(a) hereof have been contributed by the General Partner, the Limited Partners hereby agree to promptly make non-interest bearing loans to the Partnership in an amount up to the amount that has been loaned by the General Partner pursuant to item (7) of Section 2.1(a) hereof, not to exceed a maximum of One Million Five Hundred Thousand Dollars ($1,500,000.00) at any time outstanding, unless such amount is increased as provided for in this Section. Such loans shall be advanced by the Limited Partners pro rata in accordance with their respective Percentage Interests. In the event that additional debt is ever incurred by the Partnership due to a refinancing of the Permanent Loan or due to expansion of the Hotel (herein "Additional Debt"), then in that event the maximum liability of the General Partner to

make loans pursuant to Section 2.1(a)(7) hereof and the maximum liability of the Limited Partners to make loans pursuant to this Section 2.1(b)(4) shall be increased over and above the $1,500,000.00 stated therein as follows:

The liability of the Limited Partners and the liability of the General Partner to make loans shall be increased by taking 16.67% of the Additional Debt and adding such amount to $1,500,000.00 and such new amount shall be the maximum liability that the Limited Partners and the General Partner shall have to make loans pursuant to this Section 2.1.

Notwithstanding any provisions in this Agreement or any provision of the Texas Uniform Limited Partnership Act or any law or statute to the contrary, the General Partner shall never under any circumstances be personally liable to the Limited Partners for any loans which they make pursuant to this Section 2.1, nor shall the General Partner request funds pursuant to Section 2.1(a)(7) or 2.1(b)(4) for other than ordinary Partnership purposes nor shall funds loaned pursuant to Section 2.1(a)(7) or 2.1(b)(4) be used for the purpose of expanding the Hotel or for paying any of the initial costs of completing, equipping, or furnishing the Hotel.

Each Limited Partner hereby grants to the General Partner a security interest in his Partnership Interest for the purpose of securing his obligations pursuant to Sections 2.1(b), (1), (2), (3) and (4). In order to perfect such security interest, each Limited Partner hereby agrees to execute a Uniform Commercial Code financing statement evidencing this grant of a security interest. All obligations of Limited Partners under this Section 2.1(b) shall be several and not joint.

2.2 *Failure of Class B Limited Partners to Provide Funds.* Upon the failure of a Class B Limited Partner (the "Defaulting Class B Limited Partner") to provide

funds or the letter of credit required pursuant to Section 2.1(b)(1), (2), (3), or (4), the General Partner shall notify the Limited Partners in writing of such default and the other Class B Limited Partners shall have an exclusive option for a period of thirty (30) days after the mailing of such notice to purchase, pro rata in accordance with the respective Percentage Interests of the Class B Limited Partners electing to exercise the option (the "Electing Class B Limited Partners") or in some other proportion acceptable to all of the Electing Class B Limited Partners, all or a portion of the Partnership Interest of the Defaulting Class B Limited Partner at a price either: 1) equal to the contributions previously made to the Partnership by the Defaulting Class B Limited Partner, less cash flow distributions previously made to such Defaulting Class B Limited Partners or 2) otherwise agreed upon by the Defaulting Class B Limited Partners and the Electing Class B Limited Partners. The Electing Class B Limited Partners shall be obligated to contribute the funds required pursuant to Section 2.1(b) with respect to the Partnership Interest purchased by the Electing Class B Limited Partners.

Should the Class B Limited Partners not purchase all of the Partnership Interest of the Defaulting Class B Limited Partner pursuant to the foregoing option, the General Partner shall have an exclusive option for a period of ten (10) days following the expiration of the foregoing option to purchase all or part of the remaining portion of such Partnership Interest at a price equal to the contributions previously made to the Partnership by the Defaulting Class B Limited Partner less any cash flow distributions made to the Defaulting Class B Limited Partner. The General Partner shall be obligated to contribute the funds required pursuant to Section 2.1(b) hereof with respect to the Partnership Interest purchased by the General Partner.

Should the entire Partnership Interest of the Defaulting Class B Limited Partner not be purchased pursuant to

the options described in the preceding two paragraphs, then the Class A Limited Partners shall have an option for a period of ten (10) days following the expiration of the option described in the preceding paragraph to purchase, pro rata in accordance with the respective Percentage Interests of the Class A Limited Partners electing to exercise the option (the "Acquiring Class A Limited Partners") or in some other proportion acceptable to all of the Acquiring Class A Limited Partners, the remaining portion of the Partnership Interest of the Defaulting Class B Limited Partner, at a price equal to the contributions made to the Partnership by the Defaulting Class B Limited Partner less any cash flow distributions made to the Defaulting Class B Limited Partner. The Acquiring Class A Limited Partners shall be obligated to contribute the funds required pursuant to Section 2.1(b) hereof with respect to the Partnership Interest purchased by the Acquiring Class A Limited Partners.

In the event that all of the Partnership Interest of the Defaulting Class B Limited Partner is not purchased pursuant to the options described above, the General Partner may foreclose its security interest in the Partnership Interest of the Defaulting Class B Limited Partner, or any portion thereof, under the provisions of the Uniform Commercial Code in effect in the State of Texas, and the party purchasing the Partnership Interest shall be obligated to contribute the funds required pursuant to Section 2.1(b) hereof with respect to the Partnership Interest purchased.

2.3 *Failure of Class A Limited Partners to Provide Funds.* Upon the failure of a Class A Limited Partner (the "Defaulting Class A Limited Partner") to provide funds or the letter of credit required pursuant to Sections 2.1(b) 1, 2, 3, or 4, the General Partner shall notify the Limited Partners in writing of such default and the General Partner shall have an exclusive option for a period of 30 days after the mailing of such notice to pur-

chase all or a portion of the Partnership Interest of the Defaulting Class A Limited Partner at a price either: (1) Equal to the contributions previously made to the Partnership by the Defaulting Class A Limited Partner less any cash flow distributions made to the Defaulting Class A Limited Partner, or (2) A price otherwise agreed upon by the Defaulting Class A Limited Partner and the General Partner. The General Partner shall be obligated to contribute the funds required pursuant to Section 2.1 (b) with respect to the Partnership Interest purchased by the General Partner.

Should the General Partner not purchase all of the Partnership Interest of the Defaulting Class A Limited Partner pursuant to the foregoing option, the other Class A Limited Partners shall have an exclusive option for a period of 10 days following the expiration of the foregoing option to purchase pro rata in accordance with the respective Percentage Interests of the Class A Limited Partners electing to exercise the option (the "Acquiring Class A Limited Partners") or in some other proportion acceptable to all of the Acquiring Class A Limited Partners all or a part of the remaining portion of such Partnership Interest at a price equal to the contributions previously made to the Partnership by the Defaulting Class A Limited Partner less any cash flow distributions made to the Defaulting Class A Limited Partner. The Acquiring Class A Limited Partners shall be obligated to contribute the funds required pursuant to Section 2.1(b) with respect to the Partnership Interest purchased pursuant to this paragraph.

Should the entire Partnership Interest of the Defaulting Class A Limited Partner not be purchased pursuant to the options described in the preceding two paragraphs, then the Class B Limited Partners shall have an option for a period of 10 days following the expiration of the option described in the preceding paragraph to purchase pro rata in accordance with the respective Percentage Inter-

est of the Class B Limited Partners electing to exercise the option (the "Acquiring Class B Limited Partners") or in some other proportion acceptable to all of the Acquiring Class B Limited Partners, the remaining portion of the Partnership Interest of the Defaulting Class A Limited Partner at a price equal to the contributions previously made to the Partnership by the Defaulting Class A Limited Partner less any cash flow distributions made to the Defaulting Class A Limited Partner. The Acquiring Class B Limited Partners shall be obligated to contribute the funds required pursuant to Section 2.1(b) hereof with respect to the Partnership Interest purchased by the Acquiring Class B Limited Partners.

In the event that all of the Partnership Interest of the Defaulting Class A Limited Partner is not purchased pursuant to the options described above, the General Partner may foreclose its security interest in the Partnership Interest of the Defaulting Class A Limited Partner, or any portion thereof, under the provisions of the Uniform Commercial Code in effect in the State of Texas, and the party purchasing the Partnership Interest shall be obligated to contribute the funds required pursuant to Section 2.1(b) hereof with respect to the Partnership Interest purchased.

2.4 *Additional Contributions.* The Partners shall not be personally obligated to make any contribution or additional contributions to the capital of the Partnership or loan any funds to the Partnership except as provided for in Section 2.1 hereof. If additional capital is needed for the purposes of the Partnership as set forth in Section 1.6 hereof, then the General Partner shall attempt to borrow such additional capital on behalf of the Partnership, but in no event shall the General Partner be required to become personally liable on such loan, or pledge personal assets therefor. If, however, the General Partner is unable to borrow such additional capital on behalf of the Partnership, then the General Partner shall notify the Partners of

the need for such additional capital and shall state the specific purposes for which the call for such additional capital is being made. Thereupon all Partners shall have the right (but not the obligation) to loan the Partnership any portion of such additional funds at a reasonable rate of interest to be determined in the sole discretion of the General Partner. The General Partner shall use the additional funds as contributed solely for the purposes stated in the notice to the Partners.

2.5 *Personal Liability of Limited Partners.* Any provision contained in this Agreement to the contrary notwithstanding, it is agreed that the Limited Partners shall never be held personally liable to the Partnership or to any other person, entity, or Partner for any loss, liability, claim, or monetary or deficiency judgment except to the extent of his Initial Contribution and the additional contributions required pursuant to Section 2.1(b)(1), (2) or (3) hereof, and the Partnership and the other Partners shall look solely to the security interest granted herein for satisfaction of all other liabiliites under Section 2.1.

2.6 *Interest.* No interest shall be paid on any capital account.

Article 3.

ACCOUNTING, REPORTS, BOOKS, BANK ACCOUNT AND FISCAL YEAR

3.1 *Method of Accounting.* The partnership shall keep its accounts on a generally accepted system of accounting to be selected by the General Partner. The accounts shall readily disclose all items which the Partners are required to determine separately for income tax purposes. Depreciation of depreciable assets of the Partnership shall be taken on the straight line basis. As to matters of accounting not provided for in this Agreement, generally accepted accounting principles shall govern.

3.2 *Reports.* Within seventy-five (75) days after the end of each Partnership fiscal year, the General Partner

shall cause to be prepared by the independent public accounting firm of Laventhol & Horvath (or another national accounting firm in the United States) and distributed to each Partner, at Partnership expense, a balance sheet of the Partnership (dated as of the end of the fiscal year then ended) and a related statement of income or loss from the Partnership (for the same year), together with a Partnership tax return, and all other financial information reasonably requested by the Limited Partners. The financial information prepared and distributed to the Partners shall include all information customarily prepared and presented in an analysis of hotel operations, including, but not limited to, disclosures of occupancy rates, average rental rates per room, and such additional related information.

In addition to the foregoing, during the construction of the Hotel, the General Partner shall, on a quarterly basis, render written reports to the Limited Partners concerning the progress of the construction of the Hotel. Accompanying each such quarterly report, shall be a certificate executed by the General Partner certifying that the General Partner is not aware of any material default existing under any term or provision of the Marriott Management Agreement or any instrument or document executed with respect to the Interim Loan or the Permanent Loan. After the opening of the Hotel, the General Partner shall cause to be distributed to the Limited Partners financial statements, as received from the Marriott Corporation pursuant to the Marriott Management Agreement or otherwise, which accurately and completely reflect the operations of the Hotel.

3.3 *Confidentiality*. Any financial information, business reports or other reports of any type that are furnished to the Limited Partners shall be treated as confidential by the Limited Partners and the information contained therein shall not be disclosed by any Limited Partner to any person that is not a Partner of this Partnership or such Limited Partner's accountant or financial advisor.

In the event that the General Partner becomes aware that any Limited Partner has disclosed any of such information to any third party except as permitted herein, then the General Partner shall be entitled to enjoin such Limited Partner from taking any further action and the General Partner or the Partnership shall further be entitled to any damages sustained by them as a result of such disclosure.

3.4 *Books.* The Partnership books shall be kept at the principal place of business of the Partnership in Houston, Texas, and each Limited Partner, at his own expense, shall, at all reasonable times during regular office hours, have access to such books for the purpose of inspecting and copying same.

3.5 *Bank Accounts.* The Partnership shall maintain segregated accounts in its name in one or more banks in the State of Texas, and the cash funds of the Partnership shall be kept in such segregated accounts.

3.6 *Fiscal Year.* The fiscal year of the Partnership shall be the calendar year.

Article 4.

OPERATIONS AND OBLIGATIONS

4.1 *Rights of the General Partner as Manager.* The General Partner hereby agrees to serve as and perform the duties of the General Partner pursuant to the provisions of this Agreement. Wherever in this Agreement it provides for acts, duties or services to be performed by the General Partner, it is hereby expressly agreed and understood that the General Partner is hereby authorized and empowered to act for the Partnership and to perform all functions, duties and services authorized by the provisions of this Agreement.

Subject to the limitations of this Agreement, and to the limitations imposed by law, the General Partner (a)

shall have full, exclusive and complete authority and discretion to manage and control, and shall make all decisions affecting, the Partnership business; (b) shall have full authority to effectuate the purposes of the Partnership and to take any action required in section 1.6 hereinabove; (c) shall have full power to exercise all rights and powers generally inferred or conferred by law in connection therewith, including, without limitation, at the expense of the Partnership, to enter into agreements, to pay required fees, and to take appropriate steps to obtain any financing.

4.2 *Limitation on Powers of the General Partner.* Notwithstanding the provisions of Section 4.1 hereof, and notwithstanding any other provision in this Agreement, without the prior written consent of Limited Partners owning more than fifty-one percent (51%) of the Partnership Interests of the Limited Partners, the General Partner shall not:

(a) Sell the Hotel or the Property; provided that if Archie Bennett, Jr. owns a Partnership Interest of at least fifty percent (50%) in the General Partner, at the termination of a five-year period commencing with the Opening Date as such term is defined in the Marriott Management Agreement, the General Partner may sell the Hotel and the Property without the consent of the Limited Partners;

(b) Possess or hold any property, whether real, personal or mixed, of the Partnership, or transfer, assign or convey any rights in such property, for other than Partnership purposes;

(c) Admit additional Limited Partners to the Partnership; or

(d) Incur personal liability on behalf of itself or the Partnership in connection with the Permanent Loan described in Section 2.1(a)(1) hereof or any

subsequent mortgage that is placed on the Property or Hotel.

4.3 *Obligations of the General Partner as Manager.* The General Partner shall manage, or cause to be managed, the Partnership affairs in a prudent and businesslike manner and in accordance with good commercial practices. The General Partner will have and maintain insurance at all times with respect to the Hotel and other property of the Partnership insuring against risks of loss or damage of kinds customarily insured against by other persons similarly situated, in such amounts and by such methods as shall be prudent and appropriate. It is hereby expressly recognized by all Partners that Archie Bennett, Jr., as general partner of the General Partner, may be engaged or interested in any other business that is in competition with the business of the Partnership and it is hereby agreed that such activities will not constitute a breach of said General Partner's duties to the Partnership.

The General Partner shall act in good faith in the performance of the obligations hereunder but, notwithstanding anything contained herein to the contrary, the General Partner shall have no liability or obligation to any of the Limited Partners or the Partnership for any decision made or action taken in connection with the discharge of the duties hereunder if such decision or action is made or taken in good faith, is not in material violation of this Agreement, and is not grossly negligent, irrespective of whether the same may be reasonably prudent or whether bad judgment was exercised in connecting therewith: provided, however, that the General Partner will not intentionally do any act which would constitute a material default under the Interim Loan or the Permanent Loan without the consent of Partners owning at least seventy-five percent (75%) of the Percentage Interests. Except as provided in this Agreement, the General Partner shall have no liability to the Partnership or the Limited Partners to make any contributions or loans to the Partnership or

to personally guarantee any loans. Notwithstanding anything herein to the contrary, the General Partner has the authority to delegate the performance of its duties to qualified third persons or entities and contract to pay for such services at a reasonable rate for like services provided to hotels of like character, which payments shall be Partnership expenses, provided, however, that the General Partner shall remain responsible for the proper performance of said duties.

4.4 *Indemnification of General Partner.* The General Partner shall be indemnified and held harmless by the Partnership from and against any and all claims, demands, liabilities, costs, damages and causes of action of any nature whatsoever arising out of or incidental to the General Partner's management or the Partnership affairs, except where the claim at issue is based upon:

(a) the gross negligence, bad faith, willful misconduct or commission of a criminal act, of or by, the General Partner; or

(b) the material breach by the General Partner of any provision of this Agreement.

The indemnification rights herein contained shall be cumulative of, and in addition to, any and all rights, remedies and recourses to which the General Partner shall be entitled, whether pursuant to some other provision of this Agreement, at law or in equity.

4.5 *Rights of the Limited Partners.* The Limited Partners shall not be:

(a) personally liable for any of the debts, losses or other obligations of the Partnership (including deficits in the capital accounts of the Partnership, anything to the contrary herein inferable notwithstanding);

(b) allowed to take part in the management or control of the Partnership business, or to sign for or

bind the Partnership, such power to vest solely and exclusively in the General Partner;

(c) entitled to be paid any salary or to have a Partnership drawing account;

(d) entitled to receive any interest on his capital contribution;

(e) entitled to a partition of any Partnership properties except in the event of dissolution as may be provided for herein;

(f) entitled to a return of his capital contribution, except as provided for herein.

Any Limited Partner may engage in other businesses, including businesses that are in competition with the business of the Partnership, without the consent of the General Partner or any other Limited Partner.

4.6 *Transfers of Limited Partnership Interests.* No transfer, sale, assignment, pledge or hypothecation, or other disposition, howsoever accomplished, whether voluntary or involuntary, of any Limited Partner's Partnership Interest shall be effective unless and until the following conditions (the "Conditions") have been satisfied:

(a) unless otherwise provided for herein, no Partnership Interest may be transferred, sold, assigned, pledged, hypothecated, or otherwise disposed or encumbered without the written approval of the General Partner, which consent will not be unreasonably or arbitrarily withheld or delayed;

(b) no transfer of Partnership Interests may be made unless the transferor furnishes to the General Partner for the benefit of the Partnership an opinion of counsel for such transferor satisfactory to the General Partner to the effect that the transfer may be made without violation of the Securities Act of 1933 or the Securities Act of the State of Texas;

(c) no transfer of Partnership Interests may be made unless the transferee furnishes to the General Partner on behalf of the Partnership a written confirmation executed by the transferee making all of the representations of a Limited Partner contained in this Agreement;

(d) no transfer of Partnership Interests may be made if as a result of such transfer an aggregate of 50% or more of all outstanding Partnership Interests in the Partnership would have been transferred within a twelve month period or the Partnership would otherwise be terminated for federal tax purposes; and

(e) the transferee shall pay the Partnership all costs and expenses, including attorney's fees, incurred by the Partnership in connection with the transfer.

If the Conditions are satisfied, the successor shall become a substituted Limited Partner hereunder. If, however, any involuntary transfer of a Limited Partnership ownership interest shall occur, such as by way of will or intestate succession, operation of law or order of any judicial authority other than Bankruptcy, the successor to the Partnership Interest of the Limited Partner shall become a substituted Limited Partner hereunder without approval by the General Partner, and said transferee shall succeed to all rights, duties and obligations of such Limited Partner. The Limited Partner whose interest in the Partnership is transferred, voluntarily or involuntarily, shall be and remain obligated for the performance and payment of any and all obligations incurred, if any, by such Limited Partner prior to the date of such transfer.

Prior to any proposed sale or voluntary transfer of all or part of the Partnership Interest (the "Offered Partnership Interest") of any Limited Partner (the "Offering Limited Partner") in accordance with the provisions of this Agreement, the Offering Limited Partners shall give notice and the Limited Partners of the same class of Lim-

ited Partners of which the Offering Limited Partner is a member shall have an exclusive option for a period of 30 days to purchase, pro rata in accordance with their respective Partnership Interests, all of the Offered Partnership Interest at the same price and upon the same terms as the Offering Limited Partner proposes to sell or transfer the Offered Partnership Interest.

Should the foregoing option not be exercised, the Offering Limited Partner shall give notice and the General Partner shall have an exclusive option to purchase all of the Offered Partnership Interest for a period of 10 days running from the receipt of such notice from the Offering Limited Partner at the same price and upon the same terms as the Offering Limited Partner proposes to sell or transfer the Offered Partnership Interest.

In the event neither of the foregoing options are exercised, the Offering Limited Partner shall give notice and the Limited Partners of the class of Limited Partners of which the Offering Limited Partner is not a member shall have an exclusive option to purchase, for a period of 10 days from the receipt of such notice from the Offering Limited Partner, pro rata in accordance with their respective Percentage Interests, all of the Offered Partnership Interest at the same price and upon the same terms as the Offering Limited Partner proposes to sell or transfer the Offered Partnership Interest.

This right shall be deemed to have been waived by the Partners if they do not notify the Offering Limited Partner of his or its intent to exercise the foregoing options within the time period specified after receiving notice in writing from the Offering Limited Partner of the proposed sale or transfer, which notice shall contain the name and address of the proposed purchaser or transferee and the price and terms of the proposed sale or transfer.

Irrespective of anything to the contrary herein contained, a Limited Partner may, after December 1, 1980, without the consent of the General Partner, and without

prior notice to any Partner, make a sale, transfer or assignment of all or any part of his Partnership Interest in the Partnership to an existing Partner named in this Agreement, or to a member of the Limited Partner's immediate family or to a trust created for the benefit of a member(s) of the Limited Partner's immediate family. The term "immediate family" shall mean and be limited to the Partner's spouse, the Partner's brother, sisters, children, grandchildren and respective spouses, if any, of such brothers, sisters, children or grandchildren.

4.7 *Failure to Comply.* Any purported sale or assignment consummated without first complying with Section 4.6 hereinabove, shall, as between the General Partner and the Partnership, on the one hand, and the person or entity to be substituted, on the other hand, be void.

4.8 *Assignment of Right to Cash Distribution.* Notwithstanding any provision in this Agreement to the contrary, any Partner may assign, either absolutely or collaterally, to any person all or any portion of his right to receive cash distributions hereunder, but not his Partnership Interest; provided, however, that any such assignment by a Limited Partner shall only be to a lending institution, and shall not be effective until delivery to the General Partner of a copy of the instrument or assignment, in recordable form, executed by both the assignor and the assignee of such right.

4.9 *Assignment by General Partner.* The General Partner may not, without the prior written consent of Limited Partners owning more than fifty-one percent (51%) of the Partnership Interests of the Limited Partners, sell, assign, convey any of its interest in the Partnership except as provided in Section 4.8.

4.10 *Right of First Refusal by Limited Partners.* In the event that the General Partner, pursuant to Section 4.2(a) hereof, desires to sell the Hotel, the General Partner shall, prior to the Partnership becoming legally bound to make any such sale, notify the Limited Partners in

writing of the receipt by him of an offer to purchase the Hotel and the Limited Partners, provided a majority in interest of the Limited Partners elect to do so, shall have the option for a period of thirty (30) days following the mailing of such written notification to purchase the entire Partnership Interest of the General Partner for the same amount (payable in the same manner) as the General Partner would have received pursuant to Section 7.6 hereof if the Hotel had been sold pursuant to such offer. The Limited Partners shall be entitled to purchase the General Partner's interest in the Partnership as herein provided, pro rata in accordance with their respective Partnership Interests. Should some, but not all of the Limited Partners, wish to exercise this purchase option, such electing Limited Partners shall have the right to purchase all but not a part of the General Partner's Partnership Interest pro rata in accordance with their respective Percentage Interest with respect to one another.

Article 5.

EXPENSES AND OTHER CHARGES TO THE PARTNERSHIP

5.1 *Permitted Expenses and Charges.* The General Partner may charge to the Partnership and pay or recover out of the Partnership funds, as and when available, the following: all reasonable expenses incurred by the General Partner to preserve, protect, or perfect the title to the Partnership Property or to maintain such Property, including, but not limited to, travel expenses, attorney's fees and court costs incurred in connection with such matters; the cost of all insurance carried in connection with the business of the Partnership; taxes on Partnership Property and services rendered to the Partnership; principal and or interest owing on any indebtedness of the Partnership, together with any expense incurred in connection with renewing or rearranging such indebtedness; and any other expensess due to third parties reasonably incurred for the

operation of the Partnership's business or for the furtherance of the Partnership purposes.

Provided, further, that if the General Partner or any individuals, companies, or other entities with which the General Partner is affiliated shall perform or provide services for the Partnership which are reasonably necessary to accomplish the purposes of the Partnership, including, but not limited to, accounting, bookkeeping, engineering, construction supervision, decorating, landscaping, management, brokerage, architectural design and the like, the General Partner or its affiliates shall be entitled to be paid for services in amounts not in excess of amounts which could be reasonably negotiated at arms' length with qualified nonaffiliated third parties for the performance of such services, provided, however, that the General Partner shall disclose all such payments, in the reports referred to in Section 3.2 above.

5.2 *Expenses and Charges Not Chargeable to the Partnership.* No expense or charges shall be paid or recovered out of Partnership funds except those provided for in Section 5.1 hereof.

Article 6.

BANKRUPTCY

6.1 *Bankruptcy of a Limited Partner.* In the event any Limited Partner shall be adjudicate a bankrupt or shall otherwise take advantage of any bankruptcy, receivership or other similar law or arrangement, the remaining Partners shall have the option to acquire, upon the terms set out in this Section 6.1, the Partnership Interest then or theretofore held by such Partner (the "Bankrupt Limited Partner"). Promptly after the happening of any of said events, the Bankrupt Limited Partner and/or his appointed representative, as the case may be, shall submit a written offer to sell such Partnership Interest, addressed to the General Partner, by United States Registered or Certified Mail, postage prepaid, re-

turn receipt requested, which notice shall state the price desired by the person sending the notice for the Partnership Interest to be sold. The General Partner shall distribute said offer to all remaining Partners and they shall have the following options:

(1) *Bankruptcy of Class B Limited Partners.* In the event a Class B Limited Partner shall declare bankruptcy or take advantage of any bankruptcy, receivership or other similar law or arrangement, the Class B Limited Partners shall have an exclusive option for a period of thirty (30) days after the mailing of such notice to elect to purchase, pro rata in accordance with their respective Percentage Interests said Partnership Interest at the price set out in the notice or at a price to be set by an appraisal committee. If all of said Partnership Interest is not so purchased, then the General Partner shall have a similar thirty (30) days exclusive option to purchase the remainder of said Partnership Interest, said thirty (30) days to run from the expiration date of the first such option. If all of said Partnership Interest is not purchased pursuant to the foregoing options, then the Class A Limited Partners shall have a similar thirty (30) days exclusive option to purchase the remainder of said Partnership Interest, pro rata in accordance with their respective Percentage Interests, said thirty (30) days to run from the expiration date of the second such option.

(2) *Bankruptcy of a Class A Limited Partner.* In the event a Class A Limited Partner shall declare bankruptcy or take advantage of any bankruptcy, receivership, or other similar law or arrangement, the General Partner shall have an exclusive option for a period of thirty (30) days after the mailing of such notice to elect to purchase said Partnership Interest at the price set out in the notice or at a price to be set by an appraisal committee. If all of said Partnership Interest is not so purchased, then the Class A Limited Partners shall have a similar thirty (30) day exclusive option to purchase the remainder of said Partnership Interest, pro-rata in accordance with their re-

spective Percentage Interests, said thirty (30) days to run from the expiration date of the first such option. If all of said Partnership Interest is not purchased pursuant to the foregoing options, then the Class B Limited Partners shall have a similar thirty (30) day exclusive option to purchase the remainder of said Partnership Interest, pro-rata in accordance with their respective percentage interests, said thirty (30) days to run from the expiration date of the second such option.

(3) *Appraisal Committee.* If any Partner entitled to purchase said Partnership Interest requests the use of an appraisal committee, then the Bankrupt Limited Partner, or his representative, shall be obligated to submit the matter to an appraisal committee; and in such event, within five (5) days after request, the Bankrupt Limited Partner, or his representative, shall name one appraiser, and the requesting Partner shall name an appraiser. If the Bankrupt Limited Partner or his representative fails or refuses to name an appraiser within the required time, the requesting Partner may name two appraisers. Similarly, if the requesting Partner fails or refuses to name an appraiser with in the required time, the Bankrupt Limited Partner, or his representative may name two appraisers. The two appraisers so selected, within five (5) days after their appointment, shall name a third appraiser. All appraisers must be disinterested, qualified real estate appraisers, and the three appraisers shall constitute the appraisal committee. The appraisal committee shall determine the value of the Partnership Interest being offered (by the average of the two appraisals closest in amount if they are unable to agree on a value), taking into consideration all relevant matters, including the value of the Partnership assets and the liabilities of the Partnership. In the event an appraisal committee is selected, the thirty (30) day option period then in effect shall be extended so as to allow the requesting Partner ten (10) days after a decision of the appraisal committee has been reached during which the requesting Partner may execute

his right to purchase the Partnership Interest. The determination of the appraisal committee shall be binding on all parties. Each party shall pay for his own appraiser and the expenses of the third appraiser shall be paid one-half by the requesting Partner and one-half by the Bankrupt Limited Partner, or his appointed representative, as the case may be.

Unless the parties mutually agree otherwise, any such sale shall take place at the principal office of the Partnership, and at the time of closing all parties involved shall execute all deeds, assignments, documents and certificates necessary to effectuate the sale and carry out the terms of the offer. Closing shall take place on any such sale under this Section within sixty (60) days after acceptance.

6.2 *Bankruptcy of the General Partner.* If the General Partner is adjudicated a bankrupt or shall otherwise take advantage of any bankruptcy, receivership or other similar law or arrangement, and said acts would result in the dissolution of the Partnership, the Limited Partners shall have the option to purchase, pro rata in accordance with their respective Percentage Interests, all or a portion of the Partnership Interest of the General Partner for a value to be determined as stated in Section 6.1 and, additionally, the Limited Partners may elect to reconstitute the Partnership pursuant to Section 8.2.

6.3 *Binding Upon Transferees.* The provisions of this Article 6 shall be binding upon any transferee of a Partner's Partnership Interest.

Article 7.

SHARING OF PARTNERSHIP INCOME OF LOSSES

7.1 *Savings to Mariner.* Subsequent to the Opening Date, as such term is defined in the Marriott Manage-

ment Agreement, but prior to any other cash distributions, there shall be distributed to the General Partner from the available cash held by the Partnership an amount equal to Four Million Dollars ($4,000,000.00), less the amount by which the actual project cost, including soft costs (as described in paragraph (6) of Section 2.1(a) hereof), of the Hotel and all improvements in connection therewith exceed $18,000,000.00.

7.2 *Allocation of Income, Expenses and Losses.* Except as set forth in Sections 7.3 and 7.4 hereof and as may be otherwise herein expressly provided for, all income, expenses, gains, losses, and federal income tax deductions and credits, including investment tax credits, of the Partnership shall be allocated for tax and accounting purposes to the Partners in the proportion of their competitive Percentage Interests. In the event that the capital account of any Partner should reflect a negative or deficit balance, through an allocation of losses, cash distributions, federal income tax deductions, depreciation or otherwise, authorized pursuant hereto, such deficit shall not constitute an asset of the Partnership, and no Partner with such a deficit balance shall be obligated by reason of such deficit to any other person, including but not limited to any Partner or the Partnership, to restore said deficit balance at any time. All distributions and allocations of losses and federal income tax deductions shall continue to be allocated pursuant to the terms hereof, notwithstanding such deficit balance.

7.3 *Allocation of Losses.* In order to reflect the greater tax basis of the Limited Partners and the fact that they are bearing the larger portion of any risk of economic losses, all items of Partnership loss shall be allocated for federal income tax and accounting purposes 1% to the General Partner and 99% to the Limited Partners (pro rata in accordance with their respective Partnership Interests) until the date the sum of all investment tax credit allocated to the Limited Partners with

respect to their Percentage Interests plus the distributions to the Limited Partners pursuant to Section 7.5 and 7.6 hereof plus one-half of the federal income tax deductions allocated to the Limited Partners with respect to their Percentage Interests exceed $4,000,000.00. Thereafter, all profits and losses shall be allocated for federal tax accounting purposes to the Partners in accordance with Section 7.2 hereof.

7.4 *Allocation of Tax Profits and Losses from Sale or Disposition of Partnership Property.* Notwithstanding the foregoing, Partnership gain from the sale, exchange, abandonment, foreclosure or any other disposition (other than by lease) of all or any portion of the Partnership Property or any interest therein or from any other capital transaction or event during any fiscal year or years shall be allocated for federal tax and accounting purposes as follows:

(a) First, there shall be allocated to each Partner that portion of such gain which equals the amount, if any, by which the aggregate of (1) all Partnership expenses, losses and deductions allocated to such Partner up to the date immediately preceding the date of sale exceeds (2) all income and gain allocated to such Partner over the same period;

(b) Second, out of the remaining gain, if any, the amount by which all cash distributions received by such Partner, including distributions pursuant to Section 7.5, 7.6 and 7.7, exceed such Partner's cash capital contributions from time to time actually contributed to such Partner; and

(c) The remaining gain, if any, shall be allocated to the Partners in accordance with their respective Percentage Interests.

7.5 *Distribution of Partnership Funds and Assets.* Notwithstanding the provisions of Section 7.3 and 7.4, all cash funds of the Partnership (other than funds dis-

tributable pursuant to Sections 7.1 and 7.6), to the extent that the same are not needed in the reasonable judgment of the General Partner for the paying of expenses of the Partnership operations and other Partnership purposes, including, but not limited to, repayment of indebtedness to third parties and to Partners, shall be distributed for each year to the Partners in proportion to their respective Percentage Interests.

7.6 *Distribution of Refinancing Funds, Sales Proceeds and Condemnation Proceeds.* Notwithstanding the provisions of Section 7.3, 7.4 and 7.5, proceeds from the refinancing, sale or condemnation of the Hotel and related improvements to the extent that the same are not needed in the reasonable judgment of the General Partner for Partnership purposes shall be distributed as follows:

(a) First, any debts secured by liens or security interests required to be discharged in connection with the realization of such proceeds shall be paid.

(b) Second, any loans made by any Partners to the Partnership shall be paid by such remaining proceeds, if any.

(c) Third, until the distributions to the Limited Partners pursuant to Sections 7.5 and this 7.6(c) exceed $4,000,000.00, 1% of such remaining proceeds, if any, shall be allocated to the General Partner and 99% shall be allocated to the Limited Partners (pro rata in accordance with their respective Percentage Interests).

(d) Fourth, 99% of such remaining proceeds, if any, shall be allocated to the General Partner and 1% shall be allocated to the Limited Partners (pro rata in accordance with their respective Percentage Interests), until the distributions to the General Partner pursuant to Sections 7.5, 7.6(c) and this 7.7(d) equal $4,000,000.00.

(e) Last, the balance of such remaining proceeds, if any, shall be distributed to the Partners in accordance with their respective Percentage Interests.

7.7 *Distribution of Partnership Property Upon Dissolution.* Notwithstanding the provisions of Section 7.3, 7.4 and 7.5, upon dissolution of the Partnership, if not reconstituted pursuant to Section 8.2 hereof, the assets and properties of the Partnership shall be used and applied first to pay or otherwise satisfy all debts and obligations of the Partnership to third party creditors, and the balance shall be distributed among the Partners (in cash of kind) as follows:

(a) First, any loans made by any Partners to the Partnership shall be paid.

(b) Second, until the distributions to the Limited Partners pursuant to Section 7.5 and 7.6 hereof and this 7.7(b) exceed $4,000,000.00, 1% of such remaining proceeds, if any, shall be allocated to the General Partner and 99% shall be allocated to the Limited Partners (pro rata in accordance with their respective Partnership Interests).

(c) Third. 99% of such remaining proceeds, if any, shall be allocated to the General Partner and 1% shall be allocated to the Limited Partners (pro rata in accordance with their respective Partnership Interests), until the distributions to the General Partner pursuant to Sections 7.5 and 7.6 and this 7.7(c) equal to $4,000,000.00.

(d) Last, the balance of such remaining proceeds, if any, shall be distributed to the Partners in accordance with their respective Percentage Interests.

7.8 *Partnership Tax Returns.* Any provision herein to the contrary notwithstanding, for United States Federal Income Tax purposes, the parties hereto hereby recognize that the Partnership will be subject to all provisions of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code of 1954 as amended; provided, however, the filing of Partnership tax returns shall not be construed to extend the purposes of the Partnership or expand the obligations or liabilities of the Limited Partners.

At the request of any Partner, the Partnership shall file an election under Section 754 of the Internal Revenue Code of 1954 as amended; such request shall be made only in case of a permitted transfer of Partnership Interests.

7.9 *Partnership Property.* Each Partner hereby expressly waives the right, if any, to require a return of his capital contributions or to require partition of the Partnership Property or any part thereof, except as provided for herein. Each Partner further acknowledges that he has no right as an individual to any of the Partnership Property or any other assets of the Partnership, but only the rights as a Partner pursuant to the Texas Uniform Limited Partnership Act as modified by the specific provisions of this Agreement.

Article 8.

DISSOLUTION AND TERMINATION

8.1 *Dissolution and Termination of the Partnership.* The Partnership shall immediately be dissolved upon:

(a) The dissolution, adjudicated bankruptcy, or failure to continue as a legal entity, of the General Partner, or the occurrence of any other act which would legally disqualify the General Partner from acting hereunder;

(b) The express written consent of Partners owning in the aggregate seventy-five percent (75%) or more of the Partnership Interests of the Partnership;

(c) The sale or other disposition (but not exchange) of all of the Partnership's assets in accordance with the terms of this Agreement;

(d) The occurrence of any other circumstance which, by law, would require that the Partnership be dissolved; or

(e) In any event, the expiration of the term of the Partnership as provided for in Section 1.5 hereinabove. The death, legal disability, divorce, bankruptcy, dissolution or expulsion of any Limited Partner shall not result in the dissolution or termination of the Partnership.

8.2 *Reconstitution.* Upon the occurrence of an event specified in Section 8.1(a) above, the Limited Partners may, upon a unanimous vote of the remaining Limited Partners, reconstitute the Partnership, and elect, by majority of Percentage Interests of such Limited Partners, a successor General Partner hereof, in which event this Partnership will continue uninterrupted, and this Partnership Agreement will be continued and ratified by all Limited Partners. Following such dissolution, the General Partner shall, if the interest of the General Partner is not totally purchased pursuant to Section 6.2 hereof, become a Limited Partner in the Partnership as to the extent of the General Partner's remaining Partnership Interest, provided that any expenses up to but not exceeding $5,000.00 incurred in reconstituting the Partnership and acquiring a successor General Partner shall be paid from the dissolved General Partner's capital account, or from distribution made thereto.

8.3 *Partnership Interests.* Unless otherwise agreed among the Limited Partners reconstituting this Partnership, the Partnership Interests (as defined herein) of each such Partner will remain the same.

8.4 *Winding Up of the Affairs of the Partnership.* In the event that the Partnership is not reconstituted pursuant to the provisions of Section 8.2, then the provisions of Seciions 8.5 and 8.6 hereinbelow shall be applied.

8.5 *Final Accounting.* Upon such dissolution, an accounting shall be made of the accounts of the Partnership and of the Partnership's assets, liabilities and operations from the date of the last previous accounting to the date of such dissolution.

8.6 *Procedure Upon Dissolution.* Upon the dissolution of the Partnership, if the Partnership is not reconstituted as provided in Section 8.2 above, the General Partner (or, in the event of a termination by reason of acts or occurrences falling within Section 8.1(a) hereinabove, a special liquidating trustee appointed by a majority in interest of the Limited Partners) shall immediately commence to wind up the Partnership's affairs as promptly as possible, but in an orderly and business-like manner, so as not to involve undue sacrifice. The proceeds of such liquidation shall be distributed as provided for in Section 7.7 herein.

Article 9.

REPRESENTATIONS AND WARRANTIES OF PARTNERS

Each Limited Partner warrants and represents the following:

(a) That he is purchasing his Partnership Interest for his own account, for investment and with no present intention of distributing, reselling, pledging, or otherwise disposing of his Interest.

(b) That he is a resident of the State of Texas, that he is the beneficial owner of the Partnership Interest stated by his name, and that he recognizes that Rule 147(e) of the General Rules and Regulations Under the Securities Act of 1933 prohibits the sale of his Interest to the resident of a state other than Texas for a period of nine (9) months from the date of the last sale of a Partnership Interest hereunder.

(c) That he is a sophisticated investor and the nature and amount of the capital contributions he agrees to make hereunder is consistent with his investment program, and that he has sufficient liquid assets to absorb the loss of his entire investment in the Partnership.

(d) That he has been furnished with sufficient written and oral information about the Partnership, the General Partner, and the Property to be purchased and developed to allow him to make an informed investment decision prior to purchasing an interest in the Partnership, and has been furnished access to any additional information that he may require.

(e) That he is fully familiar with the business proposed to be conducted by the Partnership and with the Partnership's use and proposed use of the proceeds of the sale of the Partnership Interests.

(f) That the offer and purchase of his Partnership Interest has been made in the course of a negotiated transaction involving direct communication between himself and the General Partner on behalf of the Partnership.

(g) That he has either (i) had experience in business enterprises or investments entailing risk of a type or to a degree substantially similar to those entailed in an investment in the Partnership; or (ii) has obtained independent financial advice with respect to his investment in the Partnership.

(h) That he has been advised that his Partnership Interest may not be sold, transferred, or otherwise disposed of in the absence of either an effective registration statement covering said Interest under the Securities Act of 1933, or an opinion of counsel satisfactory to the Partnership and its counsel that registration is not required under the Securities Act of 1933, and that he will have no rights to require registration of his Interest under the Securities Act of 1933, and, in view of the nature of the transaction, registration is neither contemplated or likely.

(i) That he agrees to hold the General Partner, the other Limited Partners, the Partnership or any person controlling the Partnership, and their respective heirs, successors, assigns, or other controlling persons, harmless

and to indemnify them against all liabilities, costs, and expenses incurred by them as a result of any sale or distribution by him in violation of the aforesaid Act. All representations, warranties and indemnities made by him with reference to the Securities Act of 1933 shall be deemed to be equally applicable in connection with the securities law of Texas or any other state.

(j) That he is aware that even though the Partnership Interest which he is acquiring is a limited partnership interest, that he may be held liable as a general partner for debts of the Partnership under Texas law if he participated in the control of the Partnership, whether as an employee or otherwise.

The General Partner represents and warrants the following:

(a) That while any of the initial Limited Partners remain as Limited Partners, the General Partner will not voluntarily dissolve, liquidate, cease to be a legal entity or withdraw from the Partnership.

(b) That the Hotel and related improvements will be completed substantially in accordance with the plans and specifications therefor prior to the maturity of the Interim loan, including any extensions and renewals thereof, and in accordance with the provisions of the Permanent Loan Commitment and the Marriott Management Agreement.

(c) That no material default exists under the Permanent Loan Commitment, the Interim Commitment or the Marriott Management Agreement.

(d) That all representations made by the General Partner, its agents or employees and all information furnished to the Limited Partners in connection with their purchase of Partnership Interests in the Partnership are true, correct and accurate in all material respects to the best of General Partner's knowledge and belief, but the Limited Part-

ners acknowledge that they are projections only and that actual project costs and operating results may vary substantially; and

(e) That, the General Partner will obtain an Owner's Title Policy on the Property in the amount of the Permanent Loan and in the name of the Partnership.

Should the representations and warranties of the General Partner contained herein not be performed, the General Partner shall immediately, at the request of any Limited Partner, repurchase such Limited Partner's Partnership Interest for an amount equal to the amount of the contributions and loans made by such Limited Partner to the Partnership less any cash flow distributions made to such Limited Partner and this shall be the sole remedy of the Limited Partners.

Article 10.

REPRESENTATIONS AND WARRANTIES OF ARCHIE BENNETT, JR.

Archie Bennett, Jr. represents and warrants the following:

(a) That during the term of this agreement, he will not voluntarily withdraw as general partner of the General Partner of the Partnership.

(b) That, during the term of this Agreement, he will not sell, transfer, assign, pledge, hypothecate, or otherwise dispose or encumber his general partnership interest in the General Partner except for the Security Agreement granted hereunder, although the General Partner may assign the right to receive cash flow from his general partnership interest.

Article 11.

PROHIBITED TRANSACTIONS

11.1 *Specific Acts Prohibited.* During the time of the organization or continuance of this Partnership, no Part-

ner shall (except to the extent otherwise provided herein) do any of the following with respect to his Partnership Interest:

(a) Conduct business under the name of the Partnership (or any substantially similar name) or any trademark or trade name adopted by the Partnership;

(b) Do any other act or deed with the intention of harming the operations of the Partnership;

(c) Confess a judgment against the Partnership;

(d) Assign a right of the Partnership or its Partners in specific Partnership Property, except by the General Partner to the extent otherwise permitted by this Agreement;

(e) Assign, transfer, pledge, compromise, or release any claim of the Partnership, or consent to the arbitration of any of its disputes or controversies;

(f) Create any personal liability for any Limited Partner other than the personal liability to which any Limited Partner may have agreed to in writing;

(g) Admit another person or entity as a Partner, except to the extent otherwise permitted by this Agreement;

(h) Amend or otherwise change this Agreement so as to modify the rights or obligations of the Partners as set forth herein except upon the terms and conditions provided herein;

(i) Transfer or attempt to transfer or encumber his Partnership Interest in contravention of this Agreement;

(j) Breach any provision of this Agreement or violate any provision of the Texas Uniform Limited Partnership Act.

11.2 *Breach of Agreement.* Upon any material breach of this Agreement by a Partner, any Partner may give the breaching Partner thirty (30) days written notice of such default, with a copy of said notice to all remaining Part-

ners, and allow the breaching Partner to cure the default, if possible. Upon the expiration of thirty (30) days after notice, if such default remains uncured, all parties will have the right to pursue any remedies herein provided or any other remedies provided by law or at equity. Pursuit of any remedy herein provided shall not constitute a forfeiture or waiver of any other remedy or waiver of any amount due from a breaching Partner hereunder of any damages accruing by reason of the violation of any of the terms, provisions, and covenants herein contained. A Partner found to be in breach hereof shall be responsible for the payment of all court costs and attorney's fees reasonably incurred by the remaining Partners incurred in seeking said remedies.

11.3 *No Waiver.* No waiver of any violation shall be deemed or construed to constitute a waiver of any other violation or breach of any of the terms, provisions, and covenants herein contained and forbearance to enforce one or more of the remedies herein provided upon any breach shall not be deemed or construed to constitute a waiver of such breach.

Article 12.

MISCELLANEOUS

12.1 *Notice, Reports and Statements.* All notices, reports and statements hereunder shall be deemed to have been properly furnished if mailed from within the United States by first class United States mail (registered or certified mail, return receipt requested), postage prepaid, addressed in each case to the Partners entitled thereto at the addresses set forth below their names at the end of this Agreement, or to such other address or addresses as any of the Partners shall have designated to the General Partner in writing.

12.2 *Additional Instruments.* Each Partner hereby agrees to execute all such agreements, certificates, tax

statements, tax returns, and other documents as may be required by law to effectuate the agreements contained herein.

12.3 *Applicable to Successors.* This Agreement and each provision herein (including the provisions relating to purchase rights) shall be binding upon and applicable to, and shall inure to the benefit of, the parties hereto and their respective heirs, legatees, devisees, successors and assigns, and legal representatives, except as otherwise expressly provided herein.

12.4 *Counterparts.* This Agreement may be signed in any number of counterparts, each of which shall be an original for all purposes, but all of which taken together shall constitute only one Agreement. The production of any executed counterpart of this Agreement shall be sufficient for all purposes without producing or accounting for the other counterpart thereof.

(a) Each Limited Partner hereby makes, constitutes and appoints Archie Bennett, Jr. as his true and lawful attorney in his name, place and stead to make, execute, sign, acknowledge and file with respect to the Partnership;

(i) a certificate of limited partnership pursuant to the Texas Uniform Limited Partnership Act including all information required by said Partnership Act;

(ii) such amended certificates of limited partnership as may be required by law or pursuant to the provisions of this Agreement and may be required by law to reconstitute and continue the business of the Partnership in accordance with the provisions of this Agreement;

(iii) all papers which may be deemed necessary or desirable to effect the dissolution of the Partnership after its termination; and

(iv) all such other instruments, documents and certificates which may from time to time be required by the laws

of the State of Texas and the United States of America or any political subdivision or agency thereof, to effectuate, implement, continue and defend the valid existence of the Partnership.

(b) No document or amendment executed by Archie Bennett, Jr. pursuant to this Section shall:

(i) reduce the obligations of the General Partner;

(ii) affect the rights or restrictions regarding the assignability of Partnership Interests;

(iii) modify the terms of the Partnership or amend this Agreement; or

(iv) reduce the rights or interests or enlarge the obligations of the Limited Partners.

(c) The power of attorney granted pursuant to this Section:

(i) is a special power of attorney coupled with an interest, is irrevocable and shall survive the death or disability of each Limited Partner;

(ii) is binding upon each Limited Partner and his successors and assigns upon their admission to the Partnership;

(iii) shall only be exercisable by Archie Bennett, Jr.; and

(iv) may be exercised by Archie Bennett, Jr. by listing the names of the Limited Partners of the Partnership followed by a single signature of Archie Bennett, Jr. for all of the persons whose names are so listed.

(d) The General Partner shall promptly notify the Limited Partners of any documents or amendments so executed pursuant to this Section.

12.6 *Governing Law.* This Agreement shall be construed under and in accordance with the laws of the State

of Texas, and all obligations of the parties created hereunder are performable in Harris County, Texas.

12.7 *Severability.* In case any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision thereof and this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

12.8 *Performance After Breach.* Any covenant hereof contemplating performance subsequent to the consummation, breach or termination hereof shall survive any such consummation, breach or termination.

WITNESS THE EXECUTION HEREOF as of the date first above written.

GENERAL PARTNER

Name and Address	Signature	Initial Percentage Interest	Contribution
Mariner Interests, No. 20, Ltd. c/o Archie Bennett, Jr. General Partner 1700 West Loop South, Suite 800 Houston, Texas 77027	/s/ Archie Bennett, Jr.	50%	$1.00

CLASS A LIMITED PARTNERS

Denton A. Cooley P.O. Box 20345 Houston, Texas 77005	/s/ Denton A. Cooley	5.0%	$400,000.00
Arthur M. Faris, Jr. 4818 San Jacinto Houston, Texas 77004	/s/ Arthur M. Faris, Jr.	1.875%	$150,000.00
Robert R. Debes 4126 Southwest Freeway #1625 Houston, Texas 77004	/s/ Robert R. Debes	1.5625%	$125,000.00

Name and Address	Signature	Initial Percentage Interest	Contribution
Joe Ed McLemore 1213 Hermann Drive Houston, Texas 77004	/s/ Joe Ed McLemore	1.25%	$100,000.00
Robert R. Franklin 7550 Fannin Houston, Texas 77004	/s/ Robert R. Franklin	1.25%	$100,000.00
Charles M. Burton 1700 West Loop South Houston, Texas 77027	/s/ Charles M. Burton	2.50%	$200,000.00
Joseph P. Colaco 1700 West Loop South Houston, Texas 77027	/s/ Joseph P. Colaco	3.125%	$250,000.00
Mahendra 1700 West Loop South Houston, Texas 77027	/s/ Harold Mahendra	1.25%	$100,000.00
P. V. Banavalker 1700 West Loop South Houston, Texas 77027	/s/ P. V. Banavalker	1.25%	$100,000.00
Robert B. Wilkins 6410 Fannin Houston, Texas	/s/ Robert B. Wilkins	1.25%	$100,000.00
Edward Earle 1213 Hermann Drive Houston, Texas 77004	/s/ Edward Earle	1.25%	$100,000.00
Don C. Quast 1213 Hermann Drive Houston, Texas 77004	/s/ Don C. Quast	.9375%	$75,000.00
Veasy C. Bill Buttram, Jr. 1200 Moursand Houston, Texas 77030	/s/ Veasy C. Bill Buttram	1.25%	$100,000.00
	CLASS B LIMITED PARTNERS		
Howard Boyd c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ Howard Boyd	.625%	$50,000.00
R. Bruce LaBoon c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ R. Bruce LaBoon	1.25%	$100,000.00

Name and Address	Signature	Initial Percentage Interest	Contribution
Thomas Reidy 1100 Milam Building Houston, Texas 77002	/s/ Thomas Reidy	6.25%	$500,000.00
Michael Tyson The Houston Chronicle 801 Texas Houston, Texas 77002	/s/ Michael Tyson	.50%	$40,000.00
John C. Nabors c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ John C. Nabors	.625%	$50,000.00
George Carameras El Paso Company 2727 Allen Parkway Houston, Texas	/s/ George Carameras, Jr.	.9375%	$75,000.00
Willis Witt c/o Liddell, Sapp, Zivley, Brown & Laboon 500 Gulf Building Houston, Texas 77002	/s/ Willis Witt	.50%	$40,000.00
Walter P. Zivley c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ Walter P. Zivley	1.25%	$100,000.00
Fred E. Croshaw c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ Fred E. Croshaw	1.25%	$100,000.00
W. Robert Brown c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ W. Robert Brown	2.50%	$200,000.00
Frank A. Liddell, Jr. c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ Frank A. Liddell, Jr.	3.75%	$300,000.00

Name and Address	Signature	Initial Percentage Interest	Contribution
L.S.P. Investment c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ [Illegible]	1.75%	$140,000.00
Carl Galloway c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ Carl Galloway	.625%	$50,000.00
Charles Sapp c/o Liddell, Sapp, Zivley, Brown & LaBoon 500 Gulf Building Houston, Texas 77002	/s/ Charles Sapp	4.4375%	$355,000.00

Execution for purposes of Article 10:

/s/ Archie Bennett, Jr.
ARCHIE BENNETT, JR.

Execution to evidence his withdrawal as a limited partner of Mariner/Greenspoint Ltd.

/s/ Archie Bennett, Jr., Trustee
ARCHIE BENNETT, JR., Trustee

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Case No. 388-37142-RCM-7
(CHAPTER 7)

IN RE: ARCHIE BENNETT, JR.
(S/S #451-45-5801),
Debtor.

Adversary No. 389-3110

LSP INVESTMENT PARTNERSHIP, *et al.*,
Plaintiffs,

VS.

ARCHIE BENNETT, JR.,
Defendant.

STIPULATION

[Filed August 23, 1989]

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Plaintiffs LSP Investment Partnership, et al., and Defendant Archie Bennett, Jr., hereby agree and stipulate that Plaintiffs contributed to Marriott Greenspoint Ltd. the amounts listed on the attached and incorporaed *Exhibit A*.

LIDDELL, SAPP, ZIVLEY, HILL & LABOON

By /s/ Cynthia O. Jones
D. MITCHELL MCFARLAND
CYNTHIA O. JONES
3300 Texas Commerce Tower
Houston, Texas 77002
713/226-1200
Attorneys for Plaintiffs LSP Investment Partnership, *et al.*

SHEINFELD, MALEY & KAY

By /s/ Jane Pearson Hirst
JANE PEARSON HIRST
1001 Fannin
Suite 3700
Houston, Texas 77002
713/658-8881
Attorneys for Defendant Archie Bennett, Jr.

EXHIBIT A

	Initial Contribution	First Call 1/81	($1,370,000) 12/84	($1,630,000) 1/85	($570,000) 12/85
T. Reidy	$ 500,000.00	$12,500.00	$ 85,625.00	$101,875.00	$ 35,625.00
C. Sapp	355,000.00	8,875.00	60,793.75	72,331.25	25,293.75
F. Liddell	300,000.00	7,500.00	51,375.00	61,125.00	21,375.00
W. R. Brown	200,000.00	5,000.00	34,250.00	40,750.00	14,250.00
LSP Investments	140,000.00	3,500.00	23,975.00	28,525.00	9,975.00
R. B. LaBoon	100,000.00	2,500.00	17,125.00	20,375.00	7,125.00
W. P. Zivley	100,000.00	2,500.00	17,125.00	20,375.00	7,125.00
F. E. Croshaw	100,000.00	2,500.00	17,125.00	20,375.00	7,125.00
J. E. McLemore	100,000.00	2,500.00	17,125.00	20,375.00	7,125.00
G. Carameros	75,000.00	1,875.00	———	———	———
D. C. Quast	75,000.00	1,875.00	12,843.75	15,281.25	5,343.75
J. C. Nabors	50,000.00	1,250.00	———	———	———
H. Boyd	50,000.00	1,250.00	8,562.50	10,187.50	3,562.50
C. Galloway	50,000.00	1,250.00	8,562.50	10,187.50	3,562.50
H. M. Tyson	40,000.00	1,000.00	6,850.00	8,150.00	2,850.00
W. Witt	40,000.00	1,000.00	6,850.00	8,150.00	2,850.00
TOTAL	$2,275,000.00	$56,875.00	$368,187.50	$438,062.50	$153,187.50

GRAND TOTAL: $3,292,137.50

E/COJ/LSP-013

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Case No. 388-37142-RCM-7
(CHAPTER 7)

IN RE: ARCHIE BENNETT, JR.
(Social Security #451-45-5801),
Debtor.

Adversary Proceeding No. 389-3110

LSP INVESTMENT PARTNERSHIP, *et al.*,
Plaintiffs,
v.
ARCHIE BENNETT, JR.,
Defendant.

MOTION TO CONSOLIDATE

[Filed March 28, 1989]

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Come now LSP Investment Partnership, et al., Plaintiffs in the above-referenced adversary proceeding, and pursuant to Bankruptcy Rule 1015 of the Local Bankruptcy Rules of the United States Bankruptcy Court for the Northern District of Texas, move this Court to consolidate this adversary proceeding with a case removed from the Harris County District Court to the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. In support of this Motion, Plaintiffs would show as follows;

1. On or about November 21, 1984, LSP Investment Partnership, a Texas partnership, and Charles Sapp, Howard Boyd, R. Bruce LaBoon, Thomas Reidy, H. Michael Tyson, John Nabors, George Carameros, Willis Witt, Walter P. Zivley, Fred E. Croshaw (as agent for Croshaw Investment Partnership), W. Robert Brown, Frank A. Liddell, Jr. (as agent for Obie & Co.), Carl Galloway, Robert B. Wilkins, Edward Earl, Don C. Quast and Joe E. McLemore, filed suit against Archie Bennett, Jr. and Mariner Interest No. 20, Ltd. The suit, filed in the 234th District Court of Harris County, Texas, was styled *LSP Investment Partnership, et al. v. Archie Bennett, Jr. and Mariner Interest No. 20, Ltd.* LSP Investment Partnership, et al. filed suit for breach of a partnership agreement, negligence, and breach of fiduciary duty.

2. The parties conducted discovery for the ensuing three and one-half years. During that time, thirteen depositions were taken by the parties, some of which were videotaped, massive amounts of documents were produced and reviewed by the parties, interrogatories and requests for admissions were answered, and Defendants entered into a stipulation with Plaintiffs regarding the amounts each Plaintiff contributed to the partnership.

3. The case was set to go to trial the first time on March 7th, 1988. The case was continued and reset for October of 1988. For the entire month of October, the parties were on stand-by for trial, upon forty-eight hours of notice. The parties, however, were not reached during that time period.

4. On or about November 23, 1988, Archie Bennett, Jr. filed a voluntary petition for liquidation, pursuant to Chapter 7 of the United States Bankruptcy Code.

5. On February 17, 1989, LSP Investment Partnership, et al. filed a Notice of Removal with the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, effecting the removal of the case

pending in the 234th District Court of Harris County, Texas to the Bankruptcy Court in Dallas. The clerk marked the Notice of Removal with adversary proceeding No. 389-3110.

6. Also on February 17, 1989, LSP Investment Partnership, et al. filed a complaint to determine dischargeability of debt. This adversary proceeding, styled *LSP Investment Partnership, et al. v. Archie Bennett, Jr.*, was also given the number 389-3110.

7. In the complaint of LSP Investment Partnership, et al. to determine dischargeability of debt, Plaintiffs claim that a debt owed by Debtor through breach of his fiduciary duty as general partner of the limited partnership known as Mariner/Greenspoint, Ltd. is not dischargeable. This is the same limited partnership and debt about which Plaintiffs complain in their state court suit which has been removed to the Dallas Bankruptcy Court.

8. The issues raised by Plaintiffs in the objection to discharge are identical to those raised in the lawsuit against Debtor Archie Bennett, Jr. and Mariner Interest No. 20, Ltd. in the state court suit.

9. In the interest of fairness to the parties and creditors of the bankruptcy estate, and in the interest of judicial economy, Movants LSP Investment Partnership, et al. respectfully request that the Court consolidate the case removed from Harris County District Court to the Dallas Bankruptcy Court with the adversary proceeding so that the discovery undertaken in the state court suit can be utilized by the parties. The parties will not then be required to undertake duplicative discovery.

WHEREFORE, PREMISES CONSIDERED, Movants LSP Investment Partnership, et al. respectfully request that this Court consolidate the objection to dischargeability of debt proceeding, *LSP Investment Partnership, et al. v. Archie Bennett, Jr.*, Adversary No. 389-3110 pend-

ing before this Court, with the removed case of *LSP Investment Partnership, et al vs. Archie Bennett, Jr. and Mariner Interest No. 20, Ltd.*, Adversary No. 389-3110, so that the parties can utilize the discovery already completed, and resolve all of the outstanding issues in the most efficient manner possible; and that the Court grant all other appropriate relief.

DATED this 27th day of March, 1989.

Respectfully submitted,

LIDDELL, SAPP, ZIVLEY,
HILL, & LABOON

By /s/ Cynthia O. Jones
D. MITCHELL MCFARLAND
CYNTHIA O. JONES
3300 Texas Commerce Tower
Houston, Texas 77002
713/226-1200

Attorneys-in-Charge for LSP
Investment Partnership, *et al.*

STATUTES

11 U.S.C. § 523. Exceptions to discharge

(a) A discharge under section 727, 1141,[1] 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required—

(i) was not filed; or

(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

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[1] So in original.

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $500 for "luxury goods or services" incurred by an individual debtor on or within forty days before the order for relief under this title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within twenty days before the order for relief under this title, are presumed to be nondischargeable "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act (15 U.S.C. 1601 et seq.).

(3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection,

timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that—

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 402(a)(26) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a State or any political subdivision of such State); or

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

(8) for an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless—

(A) such loan, benefit, scholarship, or stipend overpayment first became due more than 7 years (exclusive of any applicable suspension of the repayment period) before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents;

(9) for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

(10) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act;

(11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or de-

falcation while acting in a fiduciary capacity committed with respect to any depository institution or insured cerdit unions; or

(12) for malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution, except that this paragraph shall not extend any such commitment which would otherwise be terminated due to any act of such agency; [2]

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section, under section 17a(1), 17a(3), or 17a(5) of the Bankruptcy Act, under section 439A of the Higher Education Act of 1965 (20 U.S.C. 1087-3), or under section 733(g) of the Public Health Service Act (42 U.S.C. 294f) in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

(c)(1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a

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[2] So in original. The semicolon probably should be a period.

debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator, or liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

(e) Any institution-affiliated party of a depository institution or insured credit union shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11).

TEXAS PROPERTY CODE

Section 113.001. Limitation of Powers

A power given to a trustee by this subchapter does not apply to a trust to the extent that the instrument creating the trust, a subsequent court order, or another provision of this subtile conflicts with or limits the power.

§ 113.002. General Powers

Except as provided by Section 113.001, a trustee may exercise any powers in addition to the powers authorized by this subchapter that are necessary or appropriate to carry out the purposes of the trust.

TEXAS REVISED CIVIL STATUTE ANNOTATED

General partners—

Rights, powers, restrictions and liabilities

Sec. 10. (a) A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to:

(1) Do any act in contravention of the certificate.

(2) Do any act which would make it impossible to carry on the ordinary business of the partnership.

(3) Confess a judgment against the partnership.

(4) Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose.

(5) Admit a person as a general partner.

(6) Admit a person as a limited partner, unless the right so to do is given in the certificate.

(7) Continue the business with partnership property on the death, retirement or insanity of a general partner, unless the right so to do is given in the certificate.

TEXAS UNIFORM PARTNERSHIP ARTICLE

§ 21. Partner Accountable as a Fiduciary

Sec. 21. (1) Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

(2) This Section applies also to the representatives of a deceased partner engaged in the liquidation of the affairs of the partnership as the personal representatives of the last surviving partner.

CONSTITUTION OF THE UNITED STATES

Art. 1, § 8

* * * *

Section 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Deference and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * *

To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

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